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ONTARIO PROPOSALS FOR PENSION REFORM

Adapting to Social and Economic Transformation

The Honourable Larry Grossman, Q.C.
Treasurer of Ontario
and
Minister of Economics

April 1984

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Any enquiries regarding *Ontario Proposals for Pension Reform* can be directed to:

Treasurer of Ontario
c/o GMS Box 900
Queen's Park
Toronto, Ontario
M7A 1N3

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Printed by the Queen's Printer for Ontario

ISBN 0-7743-9338-6

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Propositions de l'Ontario pour la réforme des pensions.

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Imprimé par l'imprimeur de la Reine pour l'Ontario

ISBN 0-7743-9339-4

Preface

The Ontario Government's proposals for pension reform embody Ontario's view that Canadians want an improved pension system without an extension of government influence over how they prepare for retirement. Accordingly, these proposals emphasize both the need to provide adequate retirement income protection for all members of our society, and the importance of flexibility for individuals and families as they plan for retirement.

Ontario has been a leader in the development of Canada's public and private pension systems. The 1961 *Report of the Ontario Committee on Portable Pensions*, which examined the voluntary employment pension system, led to the introduction, in 1965, of Canada's first *Pension Benefits Act.* The Province played a key role in establishing the Canada Pension Plan (CPP) and has been an active and effective participant in the joint federal-provincial program. In the early 1970s, Ontario was instrumental in the review that clarified the CPP's objectives and resulted in improved benefits.

Ontario moved to the forefront of the current review of Canada's retirement system with the publication, in 1981, of the ten-volume *Report of the Royal Commission on the Status of Pensions in Ontario*. This was followed by the 1982 *Report of the Select Committee on Pensions*.

The proposals in this document reflect Ontario's continued concern for the development of an effective, responsive and well-balanced retirement income system for all Canadians.

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Summary

I. Pension Reform Objectives

The overall structure of Canada's retirement income system is fundamentally sound. However, the system should be improved so that it delivers benefits more effectively and accommodates changing social and economic circumstances. The improved system must be affordable and must provide individuals and families with maximum flexibility to plan for retirement. This can be accomplished by maintaining the current balance of mandatory and voluntary arrangements.

Voluntary pension arrangements enable Canadians to raise their retirement incomes above the basic levels provided by government programs, and allow households to tailor their supplementary pension coverage to match consumption and savings priorities, as well as any special circumstances. The growth of employment pension plan coverage and the diverse forms it has taken confirm the ability of the private pension system to respond to differing priorities and changing economic circumstances. The private pension system is also a vital source of savings to finance the investment needed to build Canada's future.

Ontario's pension reform proposals will improve both the public and private components of Canada's pension system by:

- Raising the pensions of those who depend upon government programs for their retirement income, without expanding mandatory pension arrangements;
- Increasing the fairness, benefits and accessibility of voluntary employment and private individual-based pension arrangements;
- Extending the versatility of mandatory and voluntary pension arrangements;
- Delivering better pensions to women; and
- Keeping pension costs affordable for taxpayers and the private sector, both now and in the future.

II. OAS, GIS and GAINS Improvements

Improving income guarantees under the OAS, GIS and GAINS programs is a pension reform priority. These programs need to be maintained and strengthened. Ontario proposes:

- Raising the OAS/GIS/GAINS income guarantee for singles to 60 per cent from 53 per cent of the guarantee for couples, and maintaining it at that level; and
- Raising the OAS benefit to 15 per cent of the Average Industrial Wage and maintaining it at that level.

By the end of 1984, the single elderly in Ontario will be guaranteed a basic annual income of over $8,000 and elderly couples will be guaranteed over $13,500.

III. Canada Pension Plan: Better Benefits

While Ontario does not believe that a general expansion of the CPP is warranted, the Plan's benefit structure should be updated and made more flexible, particularly as it affects women. CPP benefits should also be increased to give better pensions to those who depend primarily on government programs for their retirement income. Eligibility for CPP improvements should be retroactive so that current recipients can benefit from the changes.

Benefit Flexibility

To update the CPP's benefit structure, improve the Plan's ability to accommodate the increasingly dynamic nature of Canadians' lifetime earnings patterns, and provide the option of retiring before or after age 65, Ontario proposes:

- Ensuring that the CPP's contribution and benefit base reaches the Average Industrial Wage by 1987;
- Reducing the contributory period for receiving maximum CPP pensions from 40 to 35 years;
- Introducing actuarially reduced early retirement benefits available from age 60; and
- Introducing actuarially increased deferred retirement benefits available to age 70.

Fairer Treatment of Women

The CPP benefit structure should recognize fully the mutual contributions marital partners have made, both directly and indirectly, to the accumulation of pension credits.

Ontario proposes:

- Continuing survivor benefits upon remarriage;
- Extending credit-splitting to breakdowns of marriages and common-law unions;
- Notifying spouses automatically of credit-splitting provisions upon divorce; and
- Splitting credits automatically at retirement when the younger spouse reaches age 65.

Automatically splitting credits at retirement will have the largest impact when one spouse chooses to be a full-time homemaker. CPP credits earned by the employed spouse would be divided and both spouses would receive a monthly pension cheque based on one-half of the credits accrued during the relationship.

Improved Survivor Benefits

Existing CPP pre-retirement survivor benefits are designed to provide maximum pension income for surviving spouses over age 45 and for young survivors who are responsible for raising dependent or disabled children. These features of the CPP should be reinforced by enriching pre-retirement survivor benefits, especially for survivors aged 55 to 64.

Ontario proposes:

- Raising maximum monthly pre-retirement benefits for survivors aged 55 to 64 to $502.50 from $229.18;
- Raising maximum monthly pre-retirement benefits for survivors aged 35 to 54; and
- Raising the monthly pre-retirement flat-rate component for survivors under age 35 with dependants to $186.13 from $83.87.

CPP post-retirement survivor benefits should also be improved, with the enrichments particularly designed to help survivors who have no independent sources of retirement income.

Ontario proposes:

- Raising the post-retirement survivor pension to 80 per cent of the total CPP income received by the household; and
- Maintaining the ceiling of the survivor benefit at the level of the maximum benefit available to a single retired CPP contributor.

The 80 per cent benefit means higher CPP pensions for survivors and less reliance on income-tested government programs. For a survivor who was a non-contributor to the CPP, the maximum monthly pension would increase to $310 from $232.50. The retention of the current pension ceiling means that larger survivor benefits would not be extended to the survivors of couples with high combined lifetime earnings.

Improved Disability Benefits

The federal and provincial governments are currently reviewing Canada's system of public and private income protection programs for people who become disabled. There are increasing indications that Canadians would have better disability protection if they were covered by a separate comprehensive national scheme. The merits of such an initiative and the analyses of possible benefit and administrative structures will require more study.

As an interim step to meet the income needs of the disabled who are eligible for CPP benefits, Ontario proposes:

- Increasing the monthly disability flat-rate benefit to the OAS level of $270 from $83.87;
- Increasing the disability earnings component to 100 per cent of the retirement pension from 75 per cent; and
- Increasing the monthly flat-rate benefit for disabled children of survivors to the OAS level of $270 from $83.87.

Raising benefits for CPP contributors who become disabled recognizes that these people have been forced to leave paid employment because of serious injury or illness and that they should have the same basic income protection available to CPP contributors who voluntarily retire at age 65. The higher flat-rate benefit paid for disabled dependants of survivors acknowledges the additional cost of caring for them.

The estimated cost of Ontario's proposed CPP benefit improvements is 1.5 per cent of the Plan's contributory earnings.

IV. Canada Pension Plan: Cost and Financing

While the principles governing the CPP's benefit structure are well established, the principles that govern the Plan's long-run financing remain ambiguous. It is imperative that federal and provincial governments reach an agreement on the best method of financing already promised benefits. The financing agreement should give Canadians a clear understanding of the true cost of providing CPP pensions, smooth the path to inevitably higher pay-as-you-go contribution rates and possibly increase the Plan's partially funded status to stabilize the future contribution rate.

Cost and Financing of Current Benefits

Based upon the 1981 provincial consensus on CPP financing, currently promised benefits could be financed by:

- Legislating a schedule of annual 0.2 per cent CPP contribution rate increases, beginning in 1987, that would raise the contribution rate to nine per cent by 2013.

This financing option would increase the CPP's funded status. The larger fund and its investment earnings would enable the future CPP contribution rate to be maintained at nine per cent, even though the underlying pay-as-you-go rate may be several percentage points higher. Nine per cent is the estimated cost of providing similar benefits through funded private sector pension arrangements.

If selected, this financing alternative may require a re-evaluation of current CPP investment policy. Under existing arrangements, contributions not immediately needed to pay benefits are loaned to provincial governments at interest rates equal to rates paid on long-term Government of Canada bonds. This has been an important source of provincial financing and has helped Ontario and other provinces build a modern stock of public capital.

However, diminishing need for public capital formation in the future could free up some of the additional funds generated by the provincial consensus for investment in the private sector. To ensure that CPP funds continue to be used productively, methods of allocating these funds through the competitive capital market would have to be examined.

If the annual flow of funds under the consensus proposal proves too large for the available investment opportunities, or if institutional arrangements for allocating CPP funds through the capital market cannot be appropriately structured, other financing alternatives should be considered. Options would include contribution rate increases more moderate than those contained in the original provincial consensus, or a delay in the commencement of the 0.2 percentage point per year increase.

Cost and Financing of Benefit Improvements

The estimated cost of Ontario's proposals for improved CPP benefits is 1.5 per cent of the Plan's contributory earnings. The 1.5 per cent cost is the approximate measure of the mature pay-as-you-go contribution rate required to pay for the proposed benefits, assuming a 2.1 total fertility rate. This can be viewed as the long-run "full cost" of the new CPP benefits.

Ontario proposes financing CPP benefit increases by:

- Raising the contribution rate schedule over a five-year period by the estimated "full cost" of these improvements, with the increases commencing in the same year the new benefits become available.

This approach to CPP financing forges the necessary link between benefit increases and benefit costs, which is absent from the Plan's existing arrangements.

Retroactive eligibility for benefit improvements would be a feature of the CPP financing formula. This means that existing recipients would benefit from pension improvements and that government expenditures on income-tested support programs such as GIS and GAINS would be reduced.

Federal-Provincial Discussions

The federal and provincial governments have extensively studied CPP financing issues, and the provinces forwarded a consensus position to the federal Minister of Finance in 1981. With the work on financing that has already been done, there should be little difficulty in reaching and implementing a federal-provincial agreement on financing current CPP benefits.

An agreement on the enrichment and financing of CPP survivor and disability benefits will require more time. There has been no joint federal-provincial scrutiny of either the Green Paper's or Ontario's proposals to ensure that their respective impacts are fully understood. Discussion and study of these proposals and the proposals advocated by other provincial governments should proceed concurrently with negotiations on benefit and financing issues related to the current CPP.

V. Employment Pension Plan Reforms

There are more than 14,000 voluntarily established employment pension plans in Canada, covering more than 4.5 million workers. These plans are an integral feature of Canada's retirement income system because their benefits have been designed to accommodate the differing needs of the participating employees and employers. However, inflation, a more mobile labour force, increased participation in the labour force by women and evolving social attitudes about compensation have revealed weaknesses in plan design.

Better Private Pensions

Ontario's proposals would ensure that voluntary pension plans deliver more and better benefits, accommodate changing work patterns, recognize pensions as deferred compensation, and give young and short-service employees freedom over how they handle their savings.

Ontario proposes:

- Inflation protection for future benefits equal to at least 60 per cent of changes in the Consumer Price Index;
- Vesting after five years of service, but without compulsory locking-in until the plan member reaches age 40;
- Reasonable interest on employee contributions;
- Employer contributions equal to at least half the value of the vested benefit;
- Portability rights for terminating employees;
- Disclosure requirements benefitting plan members;
- Mandatory eligibility of full-time and part-time employees at age 30;
- Participation of plan members in directing the affairs of their pension plan; and
- Clarification of the use of surpluses in defined benefit pension plans.

Fairer Treatment of Women

While these employment pension plan reforms would be beneficial to both men and women, additional reforms are needed to ensure that the voluntary system treats women fairly.

Ontario proposes:

- Division of pension assets and pensions-in-pay between spouses upon marriage breakdowns;
- Removal of sex discrimination in pension plans;
- Mandatory post-retirement survivor benefits equal to 60 per cent of the initial pension;
- Mandatory pre-retirement survivor benefits equal to 60 per cent of the value of the contributing member's accrued pension; and
- Continuation of survivor benefits after remarriage.

VI. Individual-Based Pension Arrangements and Tax Assistance

Individual-based pension arrangements are vital if the pension system is to have the flexibility needed to meet Canadians' changing needs. Registered Retirement Savings

Plans are an attractive way for individuals to supplement pension plans provided by employers and a good alternative retirement savings vehicle for employees who work for companies that do not have pension plans. This type of pension arrangement should be updated and expanded to accommodate increased mobility in the labour force and the growth in part-time employment.

Better Coverage and Improved Portability

Changes to existing RRSP provisions should be introduced to encourage formal pension coverage among employees in small firms, and provide a flexible and inexpensive way of extending coverage to part-time workers in both large and small companies.

Ontario proposes:

- Redesigning RRSPs to permit direct employer contributions on behalf of their employees.

A specialized individual portability vehicle also needs to be established to ensure the portability of pensions earned by terminating members of employment pension plans.

Ontario proposes:

- Introducing a Locked-In Retirement Account (LIRA), which would accept and hold locked-in pension benefits transferred from employment pension plans.

Fairer and More Flexible Tax Assistance

Ontario supports the principle of lifetime comprehensive tax assistance proposed in the February 1984 federal budget. The proposed system is intended to give individuals equal access to tax assistance for retirement saving, irrespective of their mix of pension vehicles. It also provides individuals the flexibility to accumulate unused deductions for use in later years when retirement savings have increased priority. However, certain aspects of the proposed scheme require further review.

The federal proposals call for a common funding factor of nine, to be used by members of defined benefit pension plans to calculate the "deemed contribution" necessary to buy a given pension accrual. The fixed funding factor, while administratively convenient, will hinder equal access to tax assistance. It would be more equitable if different pension plans were assigned a factor that better reflects each plan's actual benefit design.

Ontario also proposes that a closer study be made of the implications of introducing tax credits for retirement savings. Tax credits could also reduce the burden of compulsory C/QPP contributions on low-income families. This will become an increasing concern as C/QPP contribution rates rise.

VII. Cost and Impact of Employment Pension Plan Reform

The value and effectiveness of any pension reform package is directly reflected in its cost. It is inescapable that if the voluntary employment pension system is to provide more and better pensions, the overall cost of private pension plans will have to increase.

Cost of Reforms

Pension plan reforms would increase overall private sector pension costs. There would be a wide variance in the increase for individual plans, but the average increase would range from 25 to 43 per cent. Reform costs would vary widely among pension plans because each is affected differently by a range of variables. However, a plan's benefit escalation practice is the variable that most affects cost increases. If a plan regularly provides ad

hoc inflation protection for its members, the impact of pension reform on plan costs would be reduced.

While percentage increases in costs can be high, the absolute level of cost increases would be manageable. Expressed as a percentage of payroll, overall costs would rise by an average of 1.8 per cent for plans that have not had ad hoc increases, and 1.2 per cent for plans that have had ad hoc increases. The impact of cost increases would be reduced by the tax deductibility of pension contributions.

Recognizing that cost increases mean more and better pensions, employees and employers should be willing to cooperate in absorbing pension reform costs. Reforms would be phased in to give employers and employees time to adjust to higher pension costs.

Impact of Costs

Overall, increased costs could cause some reduction in defined benefit formulae, the replacement of some defined benefit plans with money purchase arrangements and the wind up of some plans. While it is not possible to project the extent of these changes, they will probably not be significant if employees and employers are given sufficient time to adjust to increased pension costs. At the same time, the pension system will become more attractive, especially to short-service and part-time workers. This will increase participation in existing pension plans, and encourage the introduction of more plans.

Impact of Pensions as Deferred Compensation

The pension system will have to adapt to the recognition that pensions are deferred compensation and belong to employees. Acceptance of pensions as deferred compensation and assured pension portability will alter the structure of Canada's voluntary retirement system. Over time, an increasing proportion of retirement income will be delivered through individual-based money purchase pension vehicles, which will correspondingly reduce the relative importance of defined benefit pension plans.

VIII. Women and Pensions

Canada's current pension system has various limitations that unintentionally make it difficult for some women to prepare adequately for retirement. The Royal Commission on the Status of Pensions in Ontario observed that although retirement arrangements are not inherently discriminatory against women, their design and operation result in women obtaining minimal retirement income.

Impact of Pension Reform on Women

Ontario's pension reform proposals are designed to help solve the pension problems faced by women, and deliver them better pensions. This would be achieved by:

- Raising the OAS/GIS/GAINS guarantee for the single elderly;
- Ensuring that employment pension plans and the CPP accommodate the dynamic and varied labour force characteristics of women;
- Improving the opportunities for women to prepare for retirement through changes to RRSPs, the introduction of a LIRA and more flexible tax assistance for retirement savings;
- Recognizing pensions as family assets by splitting pension credits and assets upon breakdown of marital relationships and dividing CPP pensions at retirement; and
- Improving survivor benefits in employment pension plans and the CPP.

CPP Homemaker Pensions

Various groups have proposed the introduction of special CPP pensions to provide homemakers with direct retirement income security. However, the specific proposals that have been advanced to date could create serious inequities between individuals and households. The federal and provincial governments will be studying homemaker pension proposals to determine whether a specialized provision can be equitably incorporated into the CPP; as well, alternatives to direct homemaker pensions will be examined.

Ontario's pension reform proposals recognize that the retirement income security of full-time homemakers is probably most fairly achieved by ensuring that accumulated pension assets and credits are shared between spouses.

Conclusion

Pension reform is a dynamic process and as Canadians move towards the final resolution of issues that have consensus, it will still be necessary to continue the dialogue on the future directions of retirement income policy. Issues that will require discussion include homemakers' pensions, how best to enrich CPP survivor benefits, how to finance CPP benefits and whether tax credits should replace deductions for retirement savings.

Introduction

Canada's retirement income system offers Canadians a good balance of voluntary and mandatory pension vehicles. However, as numerous pension studies have shown,[1] the system should be improved so that it delivers benefits more effectively and adapts to changing social and economic circumstances. This is especially true with regards to the benefits provided to women.

Ontario believes that pension reform must improve the effectiveness of public and private pension programs, and also must recognize the value of freedom of choice and flexibility. Canada's retirement system, when reformed, should continue to offer a balanced mix of mandatory government plans, voluntary employment plans and flexible individual-based pension saving arrangements. The reformed system must also be affordable, today and in the future. The proposals presented in this document reflect these beliefs.

The provincial and federal governments share jurisdiction over the retirement income system. Depending upon the economic sector in which they are located, employment pension plans are regulated by either provincial or federal legislation. The federal and provincial governments are jointly responsible for the Canada Pension Plan, with changes to the Plan's benefit or financing structure requiring the approval of the provinces.[2] The parallel Quebec Pension Plan is the independent responsibility of the Province of Quebec. Federal legislation determines a pension plan's taxable status, the extent of tax assistance afforded contributions to Registered Pension Plans and Registered Retirement Savings Plans, and the benefits provided by the Old Age Security and Guaranteed Income Supplement programs. Many provinces supplement these federal programs for the elderly by providing additional benefits, such as income supplements, free prescription drugs, property tax assistance and subsidized housing. Finally, the retirement income system is also affected by federal and provincial legislation governing labour practices, family law and human rights.

The jurisdictional division of responsibility for Canada's retirement income system demands that the federal and provincial governments fully coordinate their pension reform initiatives. The two levels of government should begin negotiating a comprehensive and uniform package of reforms. Conflicting initiatives in this area must be avoided.

Ontario's position on major pension issues has been greatly influenced by the *Report of the Royal Commission on the Status of Pensions in Ontario*, the *Report of the Select Committee on Pensions* and by direct communications with the Ontario Status of Women Council, pension plan members and sponsors and individual Canadians.

Chapter I presents Ontario's pension reform objectives. The chapter also describes how employment pension plans and individual pension vehicles have developed, and underscores the importance of maintaining a balance between mandatory and voluntary pension arrangements. Chapter II sets out Ontario's proposals to improve benefits under the Guaranteed Income Supplement (GIS) and the Guaranteed Annual Income System (GAINS) programs and to maintain the established features of the Old Age Security (OAS) system. Proposals to update and improve Canada Pension Plan benefits and to ensure the Plan's financial soundness are contained in Chapters III and IV. A comprehensive set of employment pension plan reform proposals is presented in Chapter V. Reforms that would improve pension portability and the availability of individual-based retirement savings arrangements are described in Chapter VI. Chapter VII summarizes the cost and

[1]A variety of studies from a number of sources have been prepared over the last several years on the subject of reform of the pension system in Canada. Some of these are listed at the end of this document.

[2]Amendments to the CPP's benefit or financing structure require approval of at least 2/3 of the participating provinces, having in aggregate not less than 2/3 of the population of the participating provinces. The Province of Quebec is considered a participating province.

impact of proposed employment pension plan reforms. Chapter VIII describes how Ontario's proposed reforms would improve pensions for women.

A glossary of pension terms used in this document, three appendices elaborating particular issues and a list of major pension reform studies are also provided. Appendix A describes in detail the quantitative impact of pension reform on women.

I. Pension Reform Objectives and the Importance of Voluntary Pension Arrangements

Ontario believes that Canadians want an improved, affordable pension system without a major extension of government influence over how they prepare for retirement. To achieve these objectives, pension reform should maintain the current balance of mandatory and voluntary arrangements.

Voluntary pension arrangements are important because they give Canadians the opportunity to raise their retirement incomes above the basic levels provided by government programs, and allow households to tailor supplementary pension coverage to match their consumption and savings priorities, as well as any special economic circumstances they may face. The growth of employment pension plan coverage and the diverse forms it has taken confirm the ability of the private pension system to respond to differing priorities and changing economic circumstances.

Voluntary pension arrangements are also important because they have emerged as vital sources of savings that finance the investment needed to build Canada's future.

Pension Reform Objectives

Canada's current pension system divides the responsibility of preparing for retirement between government and individuals. Through the universal Old Age Security program, the contributory Canada/Quebec Pension Plans (C/QPP), the income-tested GIS program and supplemental programs such as Ontario's GAINS, government has responsibility for ensuring that all Canadians receive an adequate level of retirement income. Through the accumulation of personal savings and government-encouraged private pension arrangements, such as Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs), individuals and families are responsible for providing themselves with additional retirement income.

Ontario believes that Canadians want both aspects of their pension system improved, but without a major extension of government involvement in their retirement planning. Ontario also believes that Canadians want an affordable pension system, not only for themselves but also for their children. Pensions cannot be promised beyond the level that can be supported by the economy now or in the future, and policies cannot be introduced that hamper the economic and employment growth needed to finance pension promises.

In keeping with these objectives, Ontario's pension reform proposals would:

- Raise the pensions of those who depend upon government programs for their retirement income, without expanding mandatory pension arrangements;
- Increase the fairness, benefits and accessibility of voluntary employment and individual-based private pension arrangements;
- Expand the versatility of mandatory and voluntary pension arrangements;
- Deliver better pensions to women; and
- Keep pension costs affordable for the taxpayer and the private sector, both now and in the future.

Ontario's pension reform proposals recognize that a healthy economy with high rates of employment is the foundation of a secure pension system.

Development of Employment Pension Plans

Canada's system of voluntary employment pension plans originated with the introduction of the federal public service pension plan in 1870 and the first private pension plan in

1874. The system's steadiest and most rapid development has been since 1960. With government encouragement through tax assistance and pension legislation, employment pension plans have combined with individual-based private pension vehicles and compulsory government programs to give Canada a balanced mix of voluntary and mandatory pension arrangements.[3]

Growth of Plans and Plan Membership — Table 1

Type of Plan	1960 Plans (#)	1960 Plans (%)	1960 Members (#)	1960 Members (%)	1980 Plans (#)	1980 Plans (%)	1980 Members (#)	1980 Members (%)
Best or Final Pay	415	4.7	926,808	49.7	2,277	15.6	2,617,813	58.5
Career Average	2,370	26.6	468,247	25.1	4,516	31.0	604,029	13.5
Flat Benefit	411	4.6	177,059	9.5	1,253	8.6	972,739	21.7
Money Purchase	5,392	60.4	242,127	13.0	6,021	41.3	211,405	4.7
Other[1]	332	3.7	48,440	2.6	519	3.6	69,443	1.6
Total	8,920	100.0	1,862,681	100.0	14,586	100.0	4,475,429	100.0

Source: Statistics Canada, *Pension Plans in Canada 1980*, Catalogue Number 74-401.
[1]Includes profit sharing and composite plans.
Percentages may not total 100 due to rounding.

Table 1 summarizes the growth in voluntary employment pension plans over the last two decades. While the total number of plans grew by almost two-thirds, from about 8,900 to 14,586, the number of plan members more than doubled from 1.9 million to 4.5 million. Membership in defined benefit pension plans (that is, best or final pay, career average and flat benefit plans) has grown the most over the twenty-year period. In 1960, there were 3,196 such plans providing 84 per cent of the 1.9 million workers with formal pension coverage. By 1980, the number of defined benefit plans had grown to 8,046 with 4.2 million members, or 94 per cent of all pension plan members.

The decline of the extended family, the growth in real incomes, tax assistance for pension contributions and, with the introduction of the OAS program in 1952, the establishment of age 70 as the "official" retirement age fuelled the growing interest in pension plans. Pension plans were also instituted by employers as a fringe benefit to attract skilled workers and to reward long-service employees. The introduction in 1966 of the mandatory C/QPP and the staged reduction in the official retirement age from 70 to 65 increased public awareness of the need to save for retirement. C/QPP benefits were designed to provide a basic earnings-related pension to long-term participants in the labour force and to allow single people and families to prepare independently for retirement through participation in voluntary employment pension plans and accumulation of personal savings.

Voluntary employment pension plans are a flexible and adaptable mechanism that can be tailored to the varying retirement needs and priorities of both employees and employers. This is reflected in the wide variety of plan designs, benefit levels, eligibility requirements and early retirement provisions. The versatility of voluntary pension plans is illustrated by plan sponsors' ability to amend the benefit structure of an ongoing plan, to choose not to implement a plan or even to discontinue a plan if it no longer proves advantageous.

Table 2 records the steady growth in pension plan membership relative to the employed paid labour force. In 1960, only 37 per cent of the paid labour force belonged to pension plans. By 1976, the share had grown to 39 per cent and in 1980 it stood at 48 per cent. Con-

[3]Laurence E. Coward, "Some History on Pensions in Canada", *Pensions in Canada* (Toronto: CCH Limited, 1964), and K.G. Banting, *The Welfare State and Canadian Federalism* (Kingston: McGill-Queen's University Press, 1982).

Employment Pension Plan Membership and the Employed Paid Labour Force, Selected Years, 1960-1980			Table 2
Year	**Pension Plan Membership**	**Employed Paid Labour Force**	**Percent of Employed Paid Labour Force**
	(000's)	**(000's)**	**(%)**
1960	1,862	5,041	36.9
1965	2,295	5,996	38.3
1970	2,822	7,038	40.1
1974	3,424	8,413	40.7
1976	3,902	10,058	38.8
1978	4,193	9,508	44.1
1980	4,475	9,382	47.7

Source: Statistics Canada, *Pension Plans in Canada 1980*, Catalogue Number 74-401.

tributing to this growth in coverage was the introduction of union-negotiated flat-rate benefit plans for hourly-paid employees. As Table 1 reveals, there were 411 of these plans in 1960 covering 177,059 members or 10 per cent of all covered workers. By 1980, the number of employees belonging to flat benefit pension plans had grown more than fivefold to 972,739 or 22 per cent of all covered workers.

Most of the growth in employment pension plan coverage occurred after the introduction of provincial and federal pension plan legislation, which began with Ontario's *Pension Benefits Act* in 1965. These statutes introduced minimum standards governing pension plan vesting, funding and investment practices. The near doubling of plan membership from 2.3 to 4.5 million following the introduction of these standards shows that, in spite of the additional costs involved, both employees and employers found pension plans more worthwhile.

Responsive Pattern of Employment Pension Plan Coverage

As shown in Table 2, 47.7 per cent, or less than half, of the employed labour force in 1980 participated in voluntary employment-based pension plans. This figure has often been used as evidence of the inadequacy of Canada's voluntary pension arrangements and as support for introducing mandatory employer-sponsored pension plans or for a wholesale expansion of the compulsory Canada and Quebec Pension Plans. Such proposals assume that a move towards more mandatory pension arrangements is in the best interest of everyone affected.

However, the use of a single statistic in this instance is misleading. Detailed coverage data show that the membership pattern in voluntary pension plans has been shaped by the varied consumption and saving priorities of Canadians and the ability of employers to provide their workers with pension plans. The voluntary system typically provides employment pension coverage for employees who want, and would benefit from, supplementary private pension plans and it exempts those who do not. This has resulted in voluntary employment pension plan coverage that is responsive to individual needs.

Income, age and employment goals chiefly determine why many employees are not covered by pension plans or elect not to join a company plan when the option is available. Low wage earners often find it difficult enough to save, and participation in pension plans may only add to their difficulties by making part of their income unavailable for meeting current needs. Young workers tend to be mobile and, because of inexperience, low paid. Their need for immediate disposable income outweighs any desire to prepare for retirement 40 to 45 years into the future. While the employment goals of part-time employees vary, and

many desire pension coverage, others have little interest in accruing pension benefits, especially if it means less take-home pay.

An additional critical factor determining employment pension coverage is a company's size. Most small employers operate businesses in highly competitive industries with narrow profit margins, uncertain cash flows and a mobile labour force. Many are unable to meet the cost and administrative burden of a pension plan. Employees working for small companies may share their employer's concern and would rather contribute directly to a personal RRSP than depend upon the plan of a company whose future may not be secure.

These same economic factors explain the pattern of employment pension plan membership. The more one earns, the more one is able and willing to dedicate some proportion of income to retirement savings. With increasing age, priorities naturally shift from establishing a household and raising a family to preparing for retirement. The family's principal earners, in addition to satisfying immediate needs, are often responsible for formally accumulating savings for retirement. Other earners in the household, especially those employed part-time, frequently work to achieve particular goals, such as paying down a mortgage, and prefer cash to pensions. Finally, the more secure a firm is, the more an employer is able to handle the cost of sponsoring and guaranteeing a pension plan and the more willing are employees to participate in the plan.

Table 3 reveals how the voluntary pension system has responded to the different saving and consumption priorities of Canadians. Coverage in the private and public sectors is categorized by sex and cross-classified by age and income. The percentages indicate those CPP contributors who are also covered by voluntary employment pension plans. The income

Voluntary Pension Plan Coverage, Public and Private Sectors, 1979 — Table 3
(Per cent of CPP contributors)

PRIVATE SECTOR PLANS

Employment Income	Age of Contributor					
	Males			Females		
	18-24	25-44	45-64	18-24	25-44	45-64
Less than $7,500[1]	8.9	11.9	17.0	5.8	8.7	7.9
$ 7,500-$14,999	18.5	39.4	57.2	32.0	46.1	53.1
$15,000-$22,499	34.7	63.2	79.2	48.5	81.4	77.8
$22,500-$29,999	29.0	73.2	89.7	[2]	69.8	62.5
$30,000+	70.5	78.0	97.4	[2]	29.8	46.3

PUBLIC SECTOR PLANS

Employment Income	Age of Contributor					
	Males			Females		
	18-24	25-44	45-64	18-24	25-44	45-64
Less than $7,500[1]	6.3	32.7	25.9	20.9	37.8	23.9
$ 7,500-$14,999	60.8	78.6	87.2	85.6	87.9	81.9
$15,000-$22,499	96.1	95.0	92.8	92.3	95.6	96.6
$22,500-$29,999	99.9	98.5	95.8	38.0	98.6	99.5
$30,000+	[2]	96.8	99.4	[2]	97.0	97.7

Source: *Pensions Today and Tomorrow,* position paper (Toronto: Ontario Economic Council, 1983).
[1]$7,500 was approximately one-half the Average Industrial Wage in 1979.
[2]Insufficient data to report percentages.

classifications are in multiples of $7,500, which in 1979 was about half the Average Industrial Wage (AIW). Public sector plans are those covering civil servants, teachers and college and university employees.

These figures confirm that the voluntary system provides increasing pension coverage as age and income rise. In the private sector, more than 60 per cent of males in the 25-44 age group with incomes above the Average Industrial Wage were covered, compared to 79 per cent for employees in the 45-64 age group. In the public sector, coverage for both males and females in these income and age categories exceeded 90 per cent. Younger employees and employees paid less than the Average Industrial Wage had lower coverage levels. Private sector pension coverage for men and women aged 18 to 24 earning less than half of the AIW was nine and six per cent, respectively. Young employees in the public sector with the same earnings had a higher coverage level than their private sector counterparts. This difference can be explained in part by the compulsory and early membership provisions of many public sector pension plans.

Table 3 also shows that in each income and age group, the level of public sector coverage exceeds that in the private sector. This principally reflects the large number of small employers in the private sector who cannot generally afford to establish pension plans. In 1978, 2.7 million employees worked for 490,000 small businesses, with an average workforce of less than six individuals.[4] Since only about one per cent of all employees in the private sector were covered by plans with a membership of nine or less, the large number of small employers is a major reason for the lower level of private sector pension coverage.[5]

Because small employers often do not have employment pension plans, it should not be automatically concluded that supplementary provisions for retirement are not being made. Employees and employers can still contribute to individual or group RRSPs and accumulate real and financial assets. Data compiled by the Canadian Federation of Independent Business suggest that these latter vehicles are extensively used. When RRSPs and accumulation of real and financial assets are integrated into the definition of coverage, 90 per cent of owners/managers and 83 per cent of employees in the small businesses indicated they are making provisions for retirement.[6]

Lower levels of private sector coverage also occur because many employers require workers to be with the company for a waiting period before being eligible to join the plan. Even when eligible, some employees elect not to join. As well, most private sector plans have not been designed to cover part-time workers.[7] Over 90 per cent of Canada's 1.5 million part-time employees are in the private sector.[8]

Coverage for women in the public sector increases with income and is generally comparable to that for men with the same age and income. This same pattern, however, does not show up in the private sector. The figures reveal that women's coverage peaks in the middle age and middle income levels. This is probably not an accurate indication of what is likely to happen in the future because the role of women in the workforce is in transition. As private sector pension arrangements accommodate the new employment objectives of women, a pattern of coverage progressively increasing with age and income should emerge.

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[4]Hon. Charles Lapointe, *Small Business in Canada: A Statistical Profile, 1981* (Ottawa: Department of Industry, Trade and Commerce, 1981).

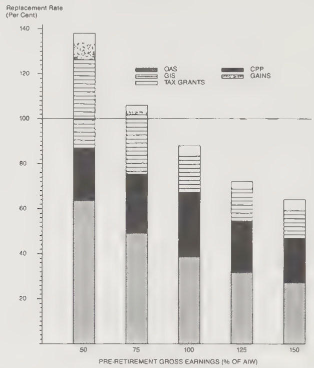
[5]Statistics Canada, *Pension Plans in Canada 1978*, Catalogue Number 74-401.

[6]C. Haehling von Lanzenauer, *Retirement Income Provisions in Canada's Independent Business Sector* (Toronto: Canadian Federation of Independent Business, 1982).

[7]Of the 329 employer-sponsored pension plans surveyed by the Financial Executives Institute, 11.6 per cent of 1.1 million employees were ineligible for plan membership because they were part-time or temporary workers. *Report on the Survey of Pension Plans in Canada*, sixth edition (Financial Executives Institute of Canada, 1983).

[8]*Part-time Work in Canada: Report of the Commission of Inquiry into Part-time Work* (Ottawa: Department of Supply and Services, 1983).

Income Replacement in Retirement provided by Government Programs for One-Earner Couple in 1984 (Percentage of Net Pre-Retirement Income) Figure 1



Source: Ontario Treasury estimates.

The pattern and extent of pension coverage in Table 3 illustrate that the current system of voluntary pension plans can respond to the diverse needs and circumstances of Canadians and is able to complement their social and economic priorities. An expansion of mandatory pension arrangements, either through the compulsory C/QPP or through mandatory employer plans, would endanger this flexibility. Unless mandatory pensions were completely redesigned to give them the flexibility to take into account individual saving priorities, many workers would be required to direct involuntarily a much larger share of earnings towards the provision of their retirement income than they would want. While Canada's system of voluntary pension arrangements is not perfect, it does work well and this should be recognized. Instead of expanding the C/QPP or mandating employer pension plans, pension reform should improve an already good voluntary system by addressing its shortcomings.

Expanded Mandatory Arrangements Burden Low-Income Households

Requiring mandatory pensions for everyone would most adversely affect families and individuals with lifetime low incomes. The introduction of mandatory employer plans, or a substantially expanded C/QPP, would mean increased pension contributions, which would reduce the take-home pay of families with already low disposable incomes. This would impose additional restrictions on low-income households by denying these families needed flexibility on how they spend and save their earnings.

Government pension programs currently guarantee most low-income Canadians with adequate retirement incomes. Figure 1 illustrates the net income replacement rates provided by government programs in 1984, for one-earner couples earning from 50 to 150 per cent of the Average Industrial Wage. The examples assume no sources of retirement income other than available from government programs.[9]

[9]See *Income Replacement Rates Provided by Government Pension Programs* (Toronto: Ministry of Treasury and Economics, forthcoming).

Savings and GNP in Canada, Three-Year Averages — Table 4

	1960-62	1963-65	1966-68	1969-71	1972-74	1975-77	1978-80	1981-82[1]
GNP ($ million)	40,311	50,541	66,941	86,650	125,441	188,414	261,311	329,102
Pension Savings ($ million)	1,043	1,383	2,500	3,491	5,386	8,641	13,076	16,915
Pension Savings as % of GNP	2.6	2.7	3.7	4.0	4.3	4.6	5.0	5.1
Gross Savings ($ million)	8,836	11,920	16,232	18,871	30,256	45,239	61,390	73,226
Pension Savings[2] as % of Gross Savings	11.8	11.6	15.4	18.5	17.8	19.1	21.3	23.1
Gross Savings as % of GNP	21.9	23.6	24.2	21.8	24.1	24.0	23.5	22.3

Source: *One in Three: Pensions for Canadians to 2030,* Economic Council of Canada (Ottawa: Department of Supply and Services, 1979) and updates by Statistics Canada, Labour Division, Pension Section.
[1]Two-year average.
[2]Pension savings include net change in cash flow of employer sponsored pension funds administered through trust agreements or insurance company contracts but do not include savings in RRSPs.

At low earnings levels, government programs provide income replacement rates that sometimes exceed 100 per cent of pre-retirement disposable earnings. For example, at three-quarters of the AIW, the universal OAS, the compulsory CPP and the income-tested GIS combine to replace 101 per cent of a one-earner couple's pre-retirement disposable earnings. Additional benefits from Ontario's supplementary GAINS and Property and Sales Tax Grant programs raise the replacement rate to 107 per cent. If the dollar value of other government benefits designed to assist the elderly, such as the waiver of premiums to the Ontario Health Insurance Plan (OHIP) and free prescription drugs, were included, the effective replacement rate would be higher.

Increased compulsory contributions accompanying a general expansion of mandatory pension arrangements would reduce the disposable income of low-income households in order to pay for the retirement income they are now guaranteed from the general revenue-financed GIS and provincial top-up programs such as Ontario's GAINS. Both the compulsory contributions during working years and the displacement of income-tested benefits in retirement would have regressive income distribution effects that would burden low-income households. Pension reform should not disadvantage low-income Canadians.

Reforms should increase the retirement income of those who depend upon government programs and maintain the current balance of mandatory and voluntary arrangements. This would ensure that low-income Canadians receive maximum benefits from pension reform and that all Canadians retain flexibility in how they save for retirement.

Voluntary Pension Savings

The growth and importance of employment pension plans as a source of investment capital is shown in Table 4. Over the three-year period 1960-62, pension savings stood at 2.6 per cent of the Gross National Product (GNP). By 1981-82, this ratio had increased to 5.1 per cent. Pension savings in employer-sponsored pension funds administered through trust agreements or insurance company contracts over the 22 years increased at a compound annual growth rate of 11.4 per cent. This outstripped the growth of both the GNP and gross savings, which increased over the same period at annual rates of 10 and 8.1

RRSP Contributions[1] 1972-1981			Table 5
Year	**$ million**	**Year**	**$ million**
1972	645	1977	2,369
1973	922	1978	2,675
1974	1,244	1979	3,091
1975	1,524	1980	3,676
1976	2,116	1981	3,879

Source: Revenue Canada Taxation, *Taxation Statistics* (Ottawa: Department of Supply and Services), various issues.

[1]These figures represent RRSP contributions claimed on tax returns and are not equal to gross savings in RRSPs. They also do not include earnings in RRSP accounts.

cent, respectively. In addition, while the ratio of gross savings to the GNP has remained fairly constant at around 22 per cent, pension savings as a share of gross savings increased from 11.8 per cent in 1960-62 to 23.1 per cent in 1981-82.

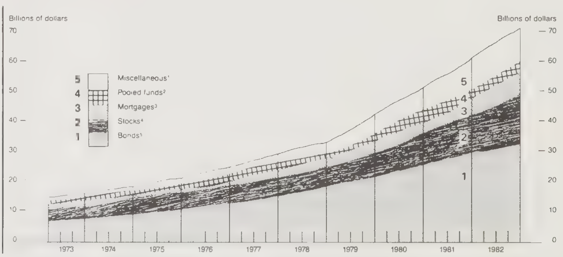
Another source of private voluntary savings is the individual-based RRSP. Although RRSPs are not included as part of pension savings in Table 4, they are a significant component of Canadian retirement savings. Contributions to RRSPs have grown in magnitude and importance over the years and are increasingly being used by people who do not belong to employment pension plans and would otherwise not be part of the private pension system. RRSPs are also widely used to supplement formal employment pension arrangements.

Table 5 gives figures for annual contributions to RRSPs in Canada for 1972 through 1981. The popularity of this form of pension savings is especially evident since 1976, when the federal government increased maximum pension contribution limits to their current levels. Over the period 1972 to 1981, RRSP contributions grew at a compound annual growth rate of 19.7 per cent. This exceeded the growth in other forms of pension savings and the growth in general economic activity.

The competitive allocation of voluntary pension savings through Canada's financial markets is also illustrated by the experience of trusteed pension plans, which is summarized in Figure 2. From 1973 to 1982, assets held by trusteed pension plans grew from $15 billion to $71 billion. The $71 billion in holdings was composed of $33 billion in corporate and government bonds, $16 billion in stocks, $7 billion in mortgages, $4 billion in pooled, mutual

Assets Held by Trusteed Pension Funds — Figure 2

Quarterly Estimates, 1973-1982



Source: Statistics Canada, *Pension Plans in Canada 1980*, Catalogue Number 74-401.

[1]Includes real estate and lease-backs.

[2]Includes mutual and segregated funds.

and segregated funds and $11 billion in various other investments, including real estate, lease-backs and short-term debt. About 70 per cent of workers covered by group pensions were members of trusteed pension plans.

The assets held by trusteed pension plans in 1982 were about 20 per cent of Canada's GNP. Even without pension reform, savings through trusteed pension plans will continue to grow in importance; total assets held by these plans are projected to be 30 to 40 per cent of the GNP by 2001.[10] Voluntary pension arrangements not only help Canadians prepare for retirement, they are also a vital and growing source of long-term investment capital.

[10] *One in Three: Pensions for Canadians to 2030*, Economic Council of Canada (Ottawa: Department of Supply and Services, 1979), Chart 6-2.

II. OAS, GIS and GAINS Improvements

The federally financed universal OAS and income-tested GIS make up the first tier of Canada's retirement income system. In Ontario, the benefits of the OAS/GIS system are supplemented by the GAINS program.

Improved GIS and GAINS Benefits

Improving income guarantees for the single elderly under the OAS, GIS and GAINS programs is a pension reform priority. Both the *Report of the Royal Commission on the Status of Pensions in Ontario* and the *Report of the Select Committee on Pensions* recommended that the income guarantee afforded single pensioners by income-tested government programs should be raised to 60 per cent of the couples guarantee to reflect the fixed costs of maintaining a household.

Ontario will raise GAINS singles payments in tandem with the announced increases in monthly GIS benefits for singles. The overall OAS/GIS/GAINS singles guarantee will be at least 60 per cent of the income guaranteed elderly couples. On July 1, 1984, when the first $25 GIS increase is introduced, the maximum monthly GAINS singles payment will be raised to $66 from $48.88. When the second $25 GIS increase is implemented on December 1, 1984, the GAINS payment will be raised to $83. These increases will also apply to elderly couples with one spouse under age 65.

By the end of 1984, the single elderly in Ontario will be guaranteed a basic annual income of over $8,000 and elderly couples will be guaranteed over $13,500. The actual amounts will depend upon the quarterly indexing of OAS and GIS benefits.

The increased GAINS payments will benefit 124,000 single elderly in Ontario with the lowest incomes, most of whom are women. As well, over 10,000 elderly couples with one spouse under age 65 will receive higher GAINS payments. The benefit improvements will raise the cost of the GAINS program in 1984-85 to $106 million from $79 million, an increase of 34 per cent.

Commitment to OAS

The OAS program has three important aspects. First, it is an essential component of Canada's income guarantee for the elderly. Second, it is a universal pension, financed through general revenue, that has become part of every Canadian's retirement income plan. Third, it is a mechanism for Canada to recognize the life-long contributions to society of its senior citizens. This last feature has been reinforced by recent legislative amendments linking OAS benefits to the length of residence in Canada. Individuals now earn one-fortieth of the maximum OAS payment for each year of residence in Canada over the age of 18.

The OAS program needs to be maintained and strengthened. This can be accomplished, in part, by the federal government making a commitment to continue quarterly indexing of OAS benefits and to continue financing the program from general revenue.

Figure 3 illustrates that annual OAS benefits have fluctuated as a percentage of the Average Industrial Wage, rising to a high of 19.9 per cent in 1964 before the introduction of the C/QPP, and falling to a low of 12.7 per cent in 1972. Since 1970, annual OAS benefits have been consistently below 15 per cent of the AIW, even though they have been fully indexed to the CPI since 1973. In 1983, the OAS stood at 14 per cent of the AIW.

Ontario proposes that annual OAS benefits be increased to 15 per cent of the AIW and that the federal government periodically review the program to ensure that the pension is maintained at that level. Under this proposal, quarterly indexing of OAS would

Old Age Security Payments as a Per Cent of the Average Industrial Wage
1952 – 1983

Figure 3

continue, but there would also be five-year adjustments, beginning in 1985, to keep the annual benefit at 15 per cent of the AIW. The commitment to OAS would help the long-term pension planning of Canadians.[11] The estimated cost in 1985 will be about $600 million.

[11]The annual Average Industrial Wage (AIW) has been calculated using Statistics Canada's Industrial Composite. This series is being replaced by the Industrial Aggregate, which is about eight per cent lower than the Industrial Composite. Policy objectives related to the AIW should be pro-rated upwards to accommodate the change in the statistical definition. For example, a commitment to maintain OAS benefits at 15 per cent under the old definition of AIW would become a commitment to maintain OAS benefits at 16 per cent under the new AIW definition.

III. Canada Pension Plan: Better Benefits

While Ontario does not believe that a general expansion of the CPP is warranted, the Plan's benefit structure should be updated and made more flexible. CPP benefits should also be increased to give better pensions to individuals and families who depend on government programs for their retirement income.

Updated Current Benefits

Benefit changes introduced in the CPP from 1976 to 1978 should be updated. The catch-up provision of the Canada Pension Plan should be revised to ensure that the Year's Maximum Pensionable Earnings (YMPE) will equal the Average Industrial Wage (AIW) by January 1, 1987. The YMPE is the maximum amount of annual earnings on which CPP contributions and benefits are calculated. Currently the YMPE is $20,800, about $2,100 below the expected 1984 AIW.[12]

It is proposed that the eligibility age for receiving a CPP retirement pension be made more flexible to allow contributors more choice in determining when they retire. Currently, retirement pensions are only payable when the CPP contributor reaches age 65. Under the updated benefit design, a contributor would have the option of electing a CPP retirement benefit at any time between his or her 60th and 70th birthdays, with an appropriate actuarial adjustment.

For each month a contributor is under age 65, his or her pension would be reduced by 0.5 per cent, or six per cent per year. The maximum reduction would be 30 per cent. Correspondingly, for each month after the contributor's 65th birthday, his or her pension entitlement would increase by the 0.5 per cent factor. A similar provision has recently been incorporated into the Quebec Pension Plan.

Ontario proposes that the current provision terminating survivor benefits upon remarriage be amended so that survivors do not have their benefits discontinued if they remarry.

Finally, it is proposed that CPP credits be split between spouses on breakdowns of marriages and common-law unions, unless the option is waived by both spouses. As well, new administrative procedures should be introduced so that both parties to a divorce are notified of the right to split CPP credits. At present, there is no formal notification of the credit-splitting provision, and because of the general lack of awareness, few couples take up this important provision. This has generally worked to the disadvantage of women, most of whom have been losing a share of the CPP credits earned by the couple.

Credit-Splitting at Retirement

Ontario proposes that CPP credits accrued during marriage automatically be split upon retirement, when the younger spouse reaches age 65. This would explicitly recognize the mutual contribution that both spouses made towards the accumulation of CPP pension credits and that marriage and common-law relationships are cooperative partnerships. Only CPP credits earned during the time that the partners were living together would be eligible for division.

Credit-splitting in ongoing relationships will have the largest impact when one spouse chooses to be a full-time homemaker. At retirement, CPP credits earned by the employed

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[12]As explained in footnote 11, the Industrial Composite series used to calculate the AIW is being replaced by the Industrial Aggregate series. The commitment to move the YMPE to the level of the old AIW translates into maintaining the YMPE at about 108 per cent of the new AIW, as required by Section 17(6) of the *Canada Pension Plan.*

spouse would be divided and both spouses would receive a monthly pension cheque based on one-half of the credits accrued during the relationship.

Many women in paid employment will also benefit from credit-splitting because historically their incomes, for a variety of reasons, have been less than those of men. In cases where a woman has been paid less than her spouse, the split CPP credits will increase the CPP pension received by the woman in her own right, and the pensions received by both spouses will tend to equalize.

A number of proposals have been put forward, most recently by the Parliamentary Task Force on Pension Reform, to provide separate CPP pensions for homemakers, either as an addition, or an alternative, to splitting accrued CPP credits. The issue of homemakers' pensions is complex and is dealt with more specifically in Chapter VIII.

Reduced Contributory Period for Maximum Benefit

Under the current CPP benefit structure, retirement pensions are calculated only after 15 per cent of the years of lowest earnings from ages 18 to 64 are removed or "dropped" from the benefit formula. This means that a contributor's pension is calculated on the best 40 years out of a 47-year contributory period. The 15 per cent general dropout was intended to compensate contributors for periods of unemployment, education, sickness or other dislocations in worklife.

However, since the introduction of the CPP in 1966, the movement of people in and out of the paid labour force has become more commonplace. This has made the current 15 per cent drop-out provision too restrictive. Ontario proposes that the contributory period for receiving maximum CPP pensions be reduced from 40 to 35 years by raising the general drop-out provision to 25 per cent from 15 per cent. This change would make the CPP more closely parallel private sector pension plans, which generally base maximum pension accrual on a 35-year contributory period. The shorter accrual period would also acknowledge the increasingly dynamic nature of people's lifetime career patterns. It is estimated that this change will increase the overall level of CPP benefits by about six per cent, with the largest proportion of benefit increases going to individuals with low lifetime earnings.

The CPP also currently provides for a special drop-out for contributors who leave the labour force to raise children under the age of seven. It is proposed that the terms of the child-rearing drop-out amendment and its relationship to the general drop-out remain unchanged. This will maintain the intended impact of the child-rearing drop-out provision.

Improved Pre-Retirement Survivor Benefits

Ontario supports improved CPP survivor benefits, but has reservations about the proposals advanced in the federal Green Paper. As described in the federal document and its background notes, the suggested changes to survivor pensions would fundamentally alter a well-established CPP benefit structure.

Existing CPP pre-retirement survivor benefits are designed to provide maximum pension income for surviving spouses after age 45 and for young survivors who are responsible for raising dependent or disabled children. The federal proposal in the Green Paper reduces the Plan's ability to target benefits to these two groups efficiently. For example, in order to provide a three-year OAS-level bridging benefit for survivors over age 55, the federal proposals would also extend the same bridging benefit to childless survivors under age 35, and provide them additionally with a small lifetime benefit. The federal formula also means that young survivors with dependent children would receive lower benefits than they do under current CPP provisions. These are significant departures from established CPP objectives.

Instead of being weakened, the Plan's pre-retirement benefits should be reinforced by enriching existing provisions, especially for survivors aged 55 to 64.

Ontario proposes:

- Raising maximum monthly pre-retirement benefits for survivors aged 55 to 64 to $502.50 from $229.18;
- Calculating maximum monthly pre-retirement benefits for survivors aged 35 to 54 using a new formula with a sliding scale designed to benefit older survivors in particular; and
- Raising the pre-retirement flat rate component for survivors under age 35 with dependants to $186.13 from $83.87.

Table 6 compares the proposed benefit enrichments with the current CPP benefit formulae using 1984 payment levels. Improvements in the pre-retirement benefit for survivors aged 35 to 64 would be implemented by increasing the existing $83.87 flat-rate monthly benefit to the OAS level of $270 and increasing the earnings-related component to 60 per cent from 37.5 per cent. The maximum benefit available to a survivor under age 55 would be reduced in line with his or her age. The improvement in the benefit for survivors under age 35 caring for dependants would be accomplished by raising the survivor's flat-rate component to $186.13 from $83.87.

Ontario's proposal increases all survivor benefits, with the major increases being targetted towards elderly survivors nearest the official retirement age and survivors supporting dependent children. Elderly survivors aged 55 to 64 are a particular concern because the early death of their spouse often results in a sharp drop in income, with little financial relief until they reach age 65 and become eligible for Old Age Security and other benefits designed for the elderly. The OAS-level flat benefit would discontinue when the survivors reach age 65, the eligibility age for regular OAS monthly pensions.

This proposal also recognizes that survivors under age 35 should continue to be treated differently. Those with dependants receive a survivor pension whereas those without dependants do not. This distinction should be taken into consideration when redesigning CPP survivor provisions.

Benefits for survivors under age 35 are intended to assist in caring for dependants. When a survivor remarries and the responsibility for children is again shared between two adults, the adult component of the survivor benefit is currently discontinued or reduced. As well, the survivor benefit is discontinued or reduced when there are no longer dependants needing care, even if the survivor remains unmarried. In these situations, consideration could be given to introducing an endowment provision to pay the survivor a lump sum equal to two years pension payments.[13]

Improved Post-Retirement Survivor Benefits

The federal proposal to redesign post-retirement survivor benefits, in combination with credit-splitting at retirement, also departs significantly from the CPP's established benefit structure. Because a post-retirement survivor would receive 60 per cent of the CPP income received by the deceased spouse after credit-splitting without any ceiling, many survivors could receive a CPP pension that is larger than the maximum pension available to a single retiree.

[13]Upon remarriage of the surviving spouse, the children's benefit is currently discontinued only if the dependant is adopted by the new spouse. This practice would continue.

Proposed Improvements in CPP Pre-Retirement Survivor Benefits, 1984 — Table 6

PRE-RETIREMENT SURVIVOR BENEFITS (WITHOUT DEPENDANTS)

Survivor's Age	Current Formula	Monthly Maximum	Proposed Formula[1]	Monthly Maximum[2]
		($)		($)
55-64	$83.87 + 37.5% of spouse's retirement pension	229.18	$270.00 + 60% of spouse's retirement pension	502.50
45-54	$83.87 + 37.5% of spouse's retirement pension	229.18	$270.00 + 60% of spouse's retirement pension, reduced by 1/240th for each month younger than age 55	251.25 to 500.40, depending on survivor's age
35-44	$83.87 + 37.5% of spouse's retirement pension reduced by 1/120th for each month under age 45	up to 227.27, depending on survivor's age	$270.00 + 60% of spouse's retirement pension, reduced by 1/240th for each month younger than age 55	up to 249.15, depending on survivor's age

PRE-RETIREMENT SURVIVOR BENEFITS (WITH DEPENDANTS)

Survivor's Age	Current Formula	Monthly Maximum	Proposed Formula[3]	Monthly Maximum
		($)		($)
Under age 35	$83.87 for survivor plus $83.87 for each dependent child plus 37.5% of spouse's retirement pension	based on number of dependent children	$186.13 for survivor plus $83.87 for each dependent child plus 37.5% of spouse's retirement pension	based on number of dependent children

[1]Under the proposed formula all pre-retirement survivor benefits would be higher than available under the current formula.
[2]Benefit maximums for illustrative purposes only.
[3]If the survivor with dependants is over age 35, he or she would receive the larger of the survivor benefit calculated with dependent children, or without dependent children.

This would occur most often in families where both spouses had high earnings over their lifetime. For example, if both spouses were in receipt of maximum CPP pensions, the survivor would receive his or her own $387.50 monthly pension plus 60 per cent of the deceased spouse's pension. In total, the survivor would receive $620 each month, or 160 per cent of the maximum pension available to a single CPP retiree. Ontario questions whether the survivor of a couple with combined high lifetime earnings should get this bonus from the CPP.

Post-retirement survivor benefits should be improved, but enrichment should be designed particularly to help survivors who have no independent sources of retirement income.

Ontario proposes:

- Raising the post-retirement survivor pension to 80 per cent of the total CPP income received by the household; and

- Maintaining the ceiling of the survivor benefit at the level of the maximum benefit available to a single retiree.

Table 7 compares current and proposed survivor benefits including the impact of credit-splitting. By setting the CPP post-retirement survivor benefits at 80 per cent with a fixed ceiling, CPP retirement pension income is redistributed towards families with low lifetime earnings. Families with low earnings often find it difficult and even disadvantageous to supplement their mandatory CPP benefits with additional formal pension income and, with the death of the principal CPP beneficiary, the surviving spouse must frequently rely heavily on GIS income-tested supplements. For these individuals, the 80 per cent benefit means higher CPP pensions and less dependence on GIS.

As a consequence of combining credit-splitting and improved post-retirement survivor benefits, some surviving spouses will have their CPP benefits reduced. This will occur most frequently when only one spouse contributed to the CPP and is predeceased by his or her non-contributing partner.

For example, under current provisions, a CPP pension paid to the contributing spouse continues unreduced after the death of the spouse. Only if the contributing spouse dies first is the CPP pension reduced and paid as a survivor benefit. However, with credit-splitting, the total CPP income received by the household is reduced to 80 per cent regardless of which spouse dies and, as a result, a surviving CPP contributor will receive a lower benefit than under current provisions.

This benefit reduction is a consequence of applying survivorship provisions equally to both spouses. It nevertheless seems fair that if one spouse is expected to cope with a lower pension, then the principle should apply equally to the other spouse.

Improved Disability Benefits

The federal and provincial governments are currently reviewing Canada's system of public and private income protection programs for people who become disabled. The re-

Proposed Improvements in CPP Post-Retirement Survivor Benefits, 1984 — Table 7

Survivor's Age	Current Formula	Monthly Maximum	Proposed Formula	Monthly Maximum
		($)		($)
65 and older	60% of deceased's pension if survivor has no CPP pension in own right.	232.50	If one spouse was a non-contributor, 80% of CPP income flowing into the household.	310.00
	If survivor has own CPP pension, max. of 60% of survivor retirement pension plus 60% of deceased's retirement pension and survivor's retirement pension plus 37.5% of deceased's pension. Subject to a ceiling.	387.50	If both spouses were contributors, 80% of CPP income flowing into the household, subject to a ceiling.	387.50
	Ceiling on survivor's pension equal to the level of the maximum retirement pension payable in the year of death of the spouse.	387.50	No change	387.50

Proposed Improvements in CPP Disability Benefits, 1984 — Table 8

BENEFITS FOR DISABLED CONTRIBUTORS

Current Formula	Maximum	Proposed Formula	Maximum
\$83.87 + 75% of retirement pension plus \$83.87 for each dependant	\$374.50 plus \$83.87 for each dependant	\$270.00 + 100% of retirement pension plus \$83.87 for each dependant	\$657.50 plus \$83.87 for each dependant

BENEFITS FOR DISABLED DEPENDANT OF SURVIVOR

Current Formula	Maximum	Proposed Formula	Maximum
\$83.87 per disabled dependant	Depends upon number of disabled dependants	\$270.00 OAS-level benefit per disabled dependant	Depends upon number of disabled dependants

sults of this intergovernmental review, together with the 1981 *Report of the Select Committee on Company Law* and the more recent report by Paul Weiler, *Protecting the Worker from Disability: Challenge for the Eighties*, suggest that Canadians would have better disability protection if they were covered by a separate comprehensive national scheme.[14] The merits of such an initiative and the analyses of possible benefit and administrative structures will require more study.

As an interim step to meet the income needs of the disabled who are eligible for CPP benefits, Ontario proposes:

- Increasing the disability flat-rate benefit to the OAS level of \$270 from \$83.87;
- Increasing the disability earnings component to 100 per cent of the retirement pension from 75 per cent; and
- Increasing the flat-rate benefit for disabled children of survivors to the OAS level of \$270 from \$83.87.

Table 8 summarizes the proposed changes in CPP disability benefits. Raising benefits for CPP contributors who become disabled recognizes that these people have been forced to leave paid employment because of serious injury or illness and that they should have the same basic income protection available to CPP contributors who retire voluntarily at age 65. The higher flat-rate benefit paid for disabled dependants of survivors acknowledges the additional cost of caring for them. The OAS-level benefit would discontinue when the disabled recipient or dependant reaches age 65, the eligibility age for the OAS pension.

[14] *The Insurance Industry: Fifth Report on Accident and Sickness Insurance,* The Select Committee on Company Law (Toronto, 1981); P.C. Weiler, *Protecting the Worker from Disability: Challenges for the Eighties* (Toronto, 1983); *Joint Federal-Provincial Study of a Comprehensive Disability Protection Program* (Ottawa, 1983).

IV. Canada Pension Plan: Cost and Financing

While the principles governing the CPP's benefit structure are well established, the principles that govern the Plan's long-run financing remain ambiguous.[15] It is imperative that federal and provincial governments reach an agreement on the best method of financing already promised benefits. The financing agreement should give Canadians a clear understanding of the true cost of providing CPP pensions, smooth the path to inevitably higher pay-as-you-go contribution rates and possibly increase the Plan's partially funded status to stabilize the future contribution rate.

An agreement on how to finance proposed improvements in CPP benefits should also be reached. Ontario proposes that benefit enrichments be tied to a financing formula that requires current CPP contributors to pay the full cost of the additional benefits they promise themselves. Eligibility for improved benefits would be retroactive and increased contributions would finance the benefit improvements.

Benefits, Cost and Financing in Perspective

The CPP is an important and valuable instrument for achieving social and pension policy objectives.[16] This is demonstrated by the Plan's widespread acceptance and the recommendations by some groups that its benefits be significantly expanded.

However, the CPP does have its limitations. Perhaps its most serious deficiency is that the Plan's contribution rate gives an unrealistically low measure of the true cost of benefits promised. The current 3.6 per cent contribution rate pays for only about one-third of the benefits promised. By 2030, less than 50 years away, the CPP's pay-as-you-go contribution rate could exceed 11 per cent.

Because the CPP appears to be an inexpensive way of delivering pensions, there have been frequent proposals to enrich all or part of its provisions. In contrast, relatively little attention has been paid to the cost and financing of proposed changes, apart from noting that they will mean an eventual increase in the Plan's long-run contribution rate. Although higher levels of expected future contributions are acknowledged, they are rarely given serious consideration because the higher cost will not materialize for several decades. Because of this loose connection between benefits and costs, current CPP contributors run the risk of promising themselves benefits that future contributors may be reluctant to finance.

A second limitation of the CPP is that the level of its future cost is uncertain. While the Plan's pay-as-you-go contribution rate is reasonably predictable over the near future, fluctuations in fertility rates and immigration, combined with ever-changing economic conditions, make it impossible to project long-run pay-as-you-go contribution rates with confidence.

Table 9 presents contribution rate projections undertaken by the federal Department of Insurance on behalf of the Ontario Ministry of Treasury and Economics. The projections include the cost of the recent CPP child-rearing drop-out amendment and the proposed continuation of current survivor benefits upon remarriage. Updating the CPP by raising the YMPE to the AIW, credit-splitting upon marital breakdown, and introducing early and de-

[15]Hon. W. Darcy McKeough, *Financing the Canada Pension Plan,* Statement to the Meeting of the Provincial Ministers of Finance, October 20-21, 1976; Hon. W. Darcy McKeough, *Financing Options for the Canada Pension Plan,* Statement to the Federal-Provincial Ministers of Finance, December 6 and 7, 1976; Hon. W. Darcy McKeough, *Review of Issues in Financing the Canada Pension Plan* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1976); "The Funding Principles of the Canada Pension Plan", A Report to Hon. Marc Lalonde, Minister of National Health and Welfare for the Canada Pension Plan Advisory Committee (Ottawa: 1976); *Report of the Royal Commission on the Status of Pensions in Ontario,* "Ontario and the Canada Pension Plan", Volume V (Toronto: Queen's Printer, 1980).

[16]Hon. Frank S. Miller, Address to the Association of Canadian Pension Management, June 10, 1983.

Pay-As-You-Go Contribution Rates for Updated CPP Benefits, under Three Fertility Assumptions, 1990 to 2050 — Table 9
(Per cent of CPP contributory earnings)

	Total Fertility Rates[1]		
Year	**2.1**	**1.8**	**1.4**
1990	4.9	4.9	4.9
2000	6.1	6.1	6.1
2010	6.9	7.0	7.1
2020	8.8	9.2	9.8
2030	10.5	11.4	12.9
2040	10.2	11.6	13.9
2050	9.9	11.6	14.5

Source: Estimates prepared by federal Department of Insurance on behalf of Ontario Ministry of Treasury and Economics.
[1]Net annual immigration is held constant at 0.33% of domestic population throughout the period shown.

ferred retirement entitlements have little impact on cost. The projections do not include the impact of credit-splitting at retirement, reduced contributory period or proposed improvements in survivor and disability benefits.

The figures in Table 9 illustrate the uncertainty over the long-run cost of already-promised CPP benefits because of Canada's unknown demographic future. The lower the future total fertility rate, the smaller the number of CPP contributors relative to beneficiaries and the higher the required contribution rate.[17] Recent population data indicate that the total fertility rate in Canada is below the 1.8 level.[18] If the trend to fewer births continues, the pay-as-you-go CPP contribution rate in 2030 will be in the higher range between 11.4 and 12.9 per cent. Other variables, such as interest earnings on the CPP fund, real earnings growth, labour force participation, mortality and morbidity, compound the uncertainty about the level of future CPP contribution rates.

The possibility of unexpectedly high pay-as-you-go contribution rates reinforces the concern that future CPP contributors may resist their compulsory participation in the Plan. This is especially true if it is realized that similar pension benefits could be provided by funded private sector pension plans with a contribution rate of only about nine per cent.[19] It is also worth noting that demographically induced high CPP contribution rates will likely be accompanied by a higher level of general taxation to finance other demographically sensitive expenditures such as health care and OAS/GIS/GAINS benefits.[20]

Although the future security of the current level of CPP benefits is not likely in jeop-

[17]Total fertility measures the expected average births per female over her lifetime and depends on a host of complex social, economic and biological factors. Its future trend is extremely difficult to forecast, especially over the long period. Current thinking supports the view that future fertility will range from 1.5 to 2.2. As a point of reference, a sustained 2.1 fertility rate results eventually in zero population growth. See also "Why We Should Be Cautious in Accepting Forecasts of the Dependency Ratios in the 21st Century", *Pensions Today and Tomorrow: Background Studies*, Special Research Report (Toronto: Ontario Economic Council, 1984).

[18]"Ontario Population Projections, 1981 to 2006: Preliminary Results", Ontario Ministry of Treasury and Economics, forthcoming.

[19]Estimates of the cost of CPP benefits on a funded basis vary according to economic and demographic assumptions. In *One in Three*, the Economic Council of Canada estimated the funded cost to be 9.4 per cent. Ontario Treasury estimates a funded rate of 9.5 per cent. The federal Department of Insurance estimates range from 8.0 to 9.4 per cent; see *Canada Pension Plan Statutory Actuarial Report No. 6 As At December 31, 1977* (Department of Insurance: mimeo, 1977).

[20]"Demographic and Economic Aspects of Canada's Aging Population", *Issues in Pension Policy: Ontario Treasury Study 16* (Toronto: Ministry of Treasury and Economics, 1979).

ardy, the Plan's long-run financing should be put on a sounder foundation to ensure its future solvency. To achieve this goal, federal and provincial governments should begin discussions on CPP financing alternatives that:

- Develop a stronger link between future increases in CPP contribution rates and the cost of already-promised benefits; and
- Provide a mechanism for the smooth and predictable transition to inevitably higher CPP pay-as-you-go contribution rates.

The 1981 provincial consensus on financing existing CPP benefits, combined with the Ontario Royal Commission's recommendation about the size of the CPP fund relative to benefits when the Plan becomes pay-as-you-go-financed, provides one alternative that satisfies these criteria.[21]

Financing Current Benefits

Following the provincial consensus, a schedule of gradually increasing CPP contribution rates targetted to reach nine per cent over 27 years could be implemented. Beginning January 1, 1987, the combined employer-employee contribution rate would increase by 0.2 percentage points each year until 2013. This schedule of contribution rates would explicitly recognize the long-run cost of current CPP benefits and would establish when and by how much contribution rates would be increased in the future. The schedule would be reviewed periodically to see if it should be amended because of changing economic or demographic circumstances.

This financing option would increase the CPP's funded status and the larger fund and its investment earnings would maintain the future CPP contribution rate at nine per cent, even though the underlying pay-as-you-go rate may be several percentage points higher. In effect, increased funding would insulate future CPP contributors from the full impact of an aging population.[22] How long the contribution rate could be held at nine per cent would hinge mainly upon Canada's demographic future. The lower the fertility rate, the shorter the period that the CPP contribution rate could be held at nine per cent.

If selected, this financing alternative may require a re-evaluation of current investment policy. Under existing arrangements, contributions not immediately needed to pay benefits are loaned to provincial governments at interest rates equal to rates paid on long-term Government of Canada bonds. This has been an important source of provincial financing and has helped Ontario and other provinces build a modern stock of public capital.[23]

However, diminishing need for public capital formation in the future could free up some of the additional funds generated under the provincial consensus for investment

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[21] *Report of the Working Group of Provincial Officials on Retirement Income Matters* (Toronto: mimeo, 1981). The Provincial Ministers of Finance agreed that C/QPP contribution rates for current benefits should be increased by 0.2 per cent per year targetted to reach the eight to ten per cent level, with the increases beginning as soon as practicable. *Report of the Royal Commission on the Status of Pensions in Ontario* (Toronto: Queen's Printer, 1980). Pay-as-you-go financing should include a contingency fund equal to twice the cost of benefits and administration for three years in the future.

[22] In *One in Three*, the Economic Council of Canada has recommended some increase in CPP funding to reduce the Plan's contribution rates in the early decades of the next century. The federal government also recognizes that increased funding would reduce the relatively steep contribution rate increases necessary at the end of the century. See Hon. Marc Lalonde, "Action Plan for Pension Reform", *1984 Federal Budget* (Ottawa: Department of Finance, 1984).

[23] Hon. W. Darcy McKeough, "Ontario's Borrowing and Public Capital Creation", Budget Paper A, *Ontario Budget 1978* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1978); Hon. Frank S. Miller, "Public Investment and Responsible Financial Management", Budget Paper C, *Ontario Budget 1982* (Toronto: Ministry of Treasury and Economics, 1982); and K. Patterson, "The Effect of Provincial Borrowings from Universal Pension Plans on Provincial and Municipal Government Finance", Economic Council of Canada Discussion Paper No. 192 (Ottawa: mimeo, 1981).

in the private sector. To ensure that CPP funds continue to be used productively, methods of allocating these funds through the competitive capital market would have to be examined.

If the annual flow of funds from the 0.2 percentage point formula proves too large for the available public sector investment opportunities, or if institutional arrangements for allocating CPP funds through the capital market cannot be appropriately structured, then other financing alternatives should be considered. For example, contribution rate increases more moderate than those contained in the original provincial consensus, or a delay in the commencement of the 0.2 percentage point per year increase, could prove to be more acceptable. However, smaller increases in the funded status of the CPP would reduce the opportunity for stabilizing future contribution rates and for smoothing the transition to higher rates.

As recommended by the Royal Commission on the Status of Pensions in Ontario, the size of the ultimate CPP investment fund under any financing option should not be less than twice the level of benefits expected to be paid three years in advance. This small contingency fund would compensate for any short-run imbalance between contribution inflows and benefit outflows.

The relative magnitude of the future surpluses that would be generated under the provincial consensus would generally lie within the experience of the first 15 years of the Plan's existence. Contribution rate, cash-flow and fund size projections are presented in Appendix B.

Financing Benefit Improvements

The estimated cost of Ontario's proposals for improved CPP benefits is 1.5 per cent of the Plan's contributory earnings. The 1.5 per cent cost is the approximate measure of the mature pay-as-you-go contribution rate required to pay for the proposed benefits, assuming a 2.1 total fertility rate. This can be viewed as the long-run "full cost" of the new CPP benefits.

It is proposed that the Plan's contribution rate schedule be raised over a five-year period by the estimated "full cost" of these improvements, with the increases commencing in the same year the new benefits become available. This approach to CPP financing forges the necessary link between benefit increases and benefit costs, which is absent from the Plan's existing arrangements.

The "full cost" approach to financing CPP benefit improvements raises another important financing issue. Should the increased inflow of contributions be used to build a larger investment fund, or should the additional contributions be paid directly as benefits by making eligibility for the new provisions retroactive? If the former route is chosen, the large fund and additional investment earnings could help finance the benefit increases as they become payable. However, there would be concern about the manageability of such a significantly larger CPP investment fund, especially if the funding of current benefits is increased along the lines of the provincial consensus.

Ontario proposes that eligibility for enriched CPP benefits be retroactive. Granting retroactive eligibility has the advantage of immediately increasing the well-being of survivors, survivors' dependants and the disabled. In addition, to the extent that some of these CPP beneficiaries also receive income support from provincial social assistance programs, or income supplementation from the federal GIS and provincial top-up programs such as GAINS, retroactivity would reduce government expenditures on these programs. It would also alleviate concerns about a much increased CPP investment fund.

Federal-Provincial Discussions of CPP Benefit and Financing Proposals

The federal and provincial governments have extensively studied CPP financing issues, and the provinces forwarded a consensus position to the federal Minister of Finance in 1981.[24] With the work that has already been done, and with the straightforward nature of the proposed benefit updates, there should be little difficulty in reaching and implementing a federal-provincial agreement on financing the current CPP.

An agreement on the enrichment and financing of CPP survivor and disability benefits may require more time. There has been no joint federal-provincial scrutiny of either the Green Paper's or Ontario's proposals to ensure their respective impacts are fully understood. Discussion and study of these proposals and the proposals advocated by other provincial governments should proceed concurrently with negotiations on benefit and financing issues related to the current CPP. Federal and provincial governments should strive to reach an agreement on improved survivor and disability benefits, including a financing mechanism as soon as possible.

[24] *Stage I Report: The Economic and Financial Consequences of the Existing Canada and Quebec Pension Plans*, A Report to the Continuing Committee of Officials on Economic and Fiscal Matters from the Sub-Committee on the Financing of the Canada Pension Plan (Ottawa: mimeo, 1980); *Stage II Report: The Major Alternatives to the Present CPP Structure*, A Report to the Continuing Committee of Officials on Economic and Fiscal Matters from the Sub-Committee on the Financing of the Canada Pension Plan (Ottawa: mimeo, 1980).

V. Employment Pension Plan Reforms

There are over 14,000 voluntarily established employment pension plans in Canada, covering about 4.5 million workers. These plans are an integral feature of Canada's retirement income system because their benefits have been designed to accommodate the differing needs of the participating employees and employers. However, inflation, a more mobile labour force, increased participation in the labor force by women and evolving social attitudes about compensation have revealed weaknesses in plan design. These must be overcome. If voluntary plans are to continue to play their key role, they must accommodate changing work patterns, deliver more and better benefits, meet the needs of women and recognize pensions as deferred compensation.

Ontario's proposed employment pension reforms encompass the view, held by the majority of Canadians, that pensions are deferred compensation. This concept means that pensions are a part of total compensation and belong to employees, regardless of whether they are short-service or long-service, or whether the plan is contributory or non-contributory. Also, inflation-induced investment earnings should be used to finance inflation protection for pension plan members.

Ontario proposes:

- Mandatory inflation protection;
- Earlier vesting and locking-in;
- Reasonable interest on employee contributions;
- Minimum employer contributions;
- Assured portability of vested benefits;
- Better spousal provisions; and
- Pension coverage for part-time workers.

In implementing these reforms, employees and employers must be given time to adjust to higher costs, and pension plan members must retain the freedom to choose how they handle their savings, especially during their younger years when retirement planning may not be a primary concern. Also, retroactive reforms should be avoided.

Mandatory Inflation Protection

Inflation erodes the purchasing power of pension benefits fixed in nominal terms and this can impose severe financial hardship on pensioners. During the ten-year period 1972 to 1981, prices increased by an average of 8.8 per cent annually, and the real value of a pension payable in 1972 declined by 57 per cent. Even at low rates of inflation, the value of fixed pensions will decline significantly. Over ten years, a three per cent annual inflation rate will erode the value of a pension by 25.6 per cent.

The decline in the real value of a pension also represents an unfair redistribution of income among pension plan participants. As inflation reduces the value of pensions, it also induces higher nominal investment earnings, which can be used to lower plan costs, improve benefits or provide inflation protection for pensions. A portion of the higher inflation-induced investment earnings originates from the accumulated savings of retired and deferred vested members of a pension plan and should be used to escalate their benefits. If this practice is not regularly followed, the pension plan is unfairly redistributing income from retired and deferred members to other plan participants.[25]

[25]"Inflation, Indexation, Income Redistribution and Pension Plan Valuations" (Toronto: Ministry of Treasury and Economics, mimeo, 1979).

While most sponsors of defined benefit pension plans see the need to protect pensions against inflation, they are concerned about the legislation of automatic benefit escalation. Such a move, they argue, would expose them to uncertain and open-ended costs. These concerns must be taken into account in designing a proposal for mandatory inflation protection. Ontario has examined the interaction of inflation, investments and pension escalation and believes that a method of inflation protection can be devised that does not expose plan sponsors to excessive financial risk. If employment pension plans can provide their members with a reasonable and predictable degree of inflation protection, a major shortcoming in Canada's retirement income system will be rectified.

As the federal Green Paper has noted, the inflation protection method proposed by the Canadian Association of Pension Supervisory Authorities (CAPSA) is a good basis for discussion. This method is predicated on the sound principle that a long-run inflation premium in investment earnings can be used to escalate pensions.[26] However, many plan sponsors have criticized the specific terms of the CAPSA proposal as too expensive and too restrictive, especially the requirements that escalation be partly retroactive and apply to active pension plan members. Its escalation formula has also been criticized for not being more closely related to recent changes in the Consumer Price Index (CPI). Finally, the specific escalation formula is tied to an incorrect measure of investment returns.[27] Inflation protection alternatives that are more flexible, more affordable and more responsive to CPI changes should be considered.

Ontario proposes the following inflation protection formula:

- Deferred and retired members of defined benefit pension plans would have their benefits escalated annually by a minimum 60 per cent of the previous year's change in the CPI;
- Annual mandatory escalation of benefits would be capped at eight per cent;
- Inflation protection for active members in career average and flat benefit plans would be left to employee-employer negotiations; and
- Inflation protection would apply only to benefits earned on future service.

While these proposals utilize the same economic principle as the CAPSA method, they have some distinct advantages. First, because escalation is related to the previous year's change in the CPI, the formula is more responsive to recent changes in the inflation rate than CAPSA's, which is based on a five-year average of past investment yields. Second, introducing an eight per cent cap eliminates the plan sponsor's exposure to open-ended costs, while providing plan members with benefit escalation at 60 per cent of annual inflation rates, up to 13.3 per cent. The 13.3 per cent ceiling is marginally above the highest annual inflation rate experienced by Canada over the last 25 years. Third, the escalation formula is relatively simple to administer. It gives employees a clear understanding of the degree to which their pensions are protected from inflation, and gives plan sponsors a clear goal for their pension investment and financing strategies. Fourth, exempting active plan members from the escalation provision gives employees and employers the flexibility to negotiate the composition of the ongoing compensation package. Finally, the provision that inflation

[26]See Chapter IX, *The Retirement Income System in Canada: Problems and Alternative Policies for Reform,* and James E. Pesando, "The Indexing of Private Pensions: An Economist's Perspective on the Current Debate", in *Canadian Public Policy*, Winter, 1979.

[27]See Towers, Perrin, Forster and Crosby, *Perspective on CAPSA indexation proposal* (Toronto); Geoffrey N. Calvert, *Adjusting Pensions for Inflation: Is the "Excess Interest" Method the Answer?* (Housser & Co. Ltd., April 1983); William M. Mercer Limited, *The Mercer Bulletin,* August 1982; and James E. Pesando, *The Use of "Excess" Pension Fund Earnings to Provide Inflation Protection for Private Pensions,* discussion paper (Toronto: Ontario Economic Council, 1983).

protection need only apply to benefits earned on future service satisfies the concern about retroactive legislation for which the CAPSA method has been criticized.

The Parliamentary Task Force on Pension Reform also recommended a mandatory inflation protection formula designed to overcome the limitations inherent in CAPSA's proposal. The Task Force recommends that eligible pension benefits be escalated by a factor equal to the annual increase in the CPI less 2.5 per cent. Instead of imposing a fixed cap on the maximum escalation, two indicators of ability-to-pay would be used. One would be based on the annual return on a benchmark portfolio of financial investments, the other on a new measure of economic productivity.

While both the Ontario and the Task Force proposals seek the same objectives, the impact of the two approaches is potentially quite different. At 6.25 per cent inflation, both proposals give the same inflation protection and both cost the same. At inflation rates below 6.25 per cent, Ontario's formula would provide more inflation protection and be more costly. However, at inflation rates above 6.25 per cent, the Task Force's formula would provide more inflation protection and be more expensive.

Because government and Canadians have made a commitment to keep inflation low, Ontario prefers the 60 per cent formula. It provides better protection over long periods at low rates of inflation than does the CPI less 2.5 per cent formula. The proposed inflation-protection provisions would also apply to annuities purchased from money-purchase pension plans. Subject to the approval of the Pension Commission of Ontario, plan sponsors and insurers who provide equivalent or better inflation protection through a different formula would be permitted to do so, even if differences occur in single years.

The impact of inflation and different inflation protection formulae on pension plan costs is discussed in Appendix C.

Earlier Vesting and Locking-In

Vesting means that a pension plan member has the right to receive the value of the benefit accrued under the terms of the plan. Locking-in means that, upon leaving an employer, the terminating member cannot elect to receive the value of the benefit in cash; the benefit must be taken as a pension commencing at retirement. Vesting and locking-in need not occur simultaneously, although pension legislation has traditionally required locking-in and vesting to occur at the same time.

Current federal and provincial legislation typically requires vesting and locking-in only if an employee has ten years of service and has reached age 45. This provision is frequently referred to as the "45 and 10" rule.[28]

Ontario proposes that vesting of pension benefits occur after five years of service, but that locking-in not be compulsory until the employee has reached age 40 and has five years of service. The proposed "service 5" rule — vesting after five years — is a significant improvement to the legislated minimum vesting provision and embodies the principle that pensions are deferred compensation. Even earlier vesting, such as "service 2", could be considered. However, the merits of providing very-short-service employees with vested benefits of little value must be weighed against the additional expense involved, especially for firms with high employee turnover.

The proposed approach to locking-in achieves two important objectives. Not requiring locking-in before a plan member is 40 years of age and has five years of service recognizes that both young and short-service employees may need and want to retain considerable

[28]Saskatchewan requires locking-in when age plus service equals 45. Manitoba requires locking-in after five years of service effective January 1, 1985.

flexibility over how they use their savings. The responsibilities of raising a family, buying a house and clearing debt are often more urgent and beneficial to a household than the early accrual of pension benefits.[29] At the same time, advancing locking-in improves the effectiveness of employment pension plans since more people will be assured of receiving pension benefits.

The new vesting rule would apply only to service after the effective date of legislation. As under current legislation, voluntary earlier vesting and locking-in would be permitted.

Reasonable Interest on Employee Contributions

Under current legislation, employees who leave a contributory plan before vesting may receive little or no interest on their refunded contributions.[30] Similarly, an employer currently need only provide a vested terminating employee with a pension that is equal to the greater of the benefit defined under the plan and the benefit that would be provided by the value of the employee's contribution. Not crediting the employee's contributions with interest often limits the benefit available to the employee. The interest not paid to a terminating employee or not credited to a vested one is often used to reduce the employer's pension plan costs.

Ontario believes that contributory defined benefit pension plans should pay reasonable rates of interest on returned contributions and should credit reasonable interest on employee contributions used to finance vested benefits. This provision would apply to accumulated employee contributions beginning with the effective date of legislation. Money purchase plans would also be required to pay interest on employee contributions, with the rate being related to each plan's investment returns.

Minimum Employer Contributions

Currently, many so-called contributory plans use funding methods that result in short-service employees financing more than their accrued benefit. No employer contributions are involved, even though the plan is understood by members as being "contributory" for both employees and employers. In some plans, it is only after many years of service that employer contributions assist in the financing of a worker's pension.[31]

It is proposed that employers sponsoring contributory defined benefit pension plans be required to pay at least half of the vested benefit earned by a terminating or retiring employee. Minimum contributions ensure that employers share the cost of their employees' pensions and that short- and long-service workers are treated fairly. The provision would apply only to pension benefits accrued after the effective date of legislation.

Assured Portability

Employees must be allowed to withdraw the benefits accrued while working for different employers and accumulate them in one simple vehicle. This fully recognizes pensions as deferred compensation. Current legislation does not specify minimum portability standards, but increased labour mobility and changing work patterns make it essential that deferred benefits accrued under the new vesting and locking-in provisions be portable. Under

[29] J. E. Poapst, "Pension Reform—An Unexplored Option", forthcoming.

[30] Saskatchewan requires interest on contributions to be at least equal to the ten-year average yield on long term Canada Bonds. Manitoba requires interest on employee contributions to be within one per cent of actual fund earnings or based on rates paid by financial institutions.

[31] Saskatchewan requires employers to pay a minimum of 50 per cent of an employee's pension. Manitoba will require employers to pay a minimum of 50 per cent of an employee's pension effective January 1, 1985.

Ontario's proposals for portability, the options available to a terminating employee would depend upon age and whether the individual participated in a contributory or a non-contributory pension plan.

Whether a plan is contributory or non-contributory, a terminating employee who satisfies the "service 5" rule but is not 40 years of age should retain maximum discretion over accumulated savings. The employee would be allowed to choose one of the following options:

- Take a deferred pension;
- Transfer the value of the deferred pension to a portability vehicle;
- Transfer the value of the deferred pension to a locked-in portability vehicle, if the plan requires earlier locking-in; or
- Cash-out the entire value of the deferred pension.

In contributory plans, employee contributions not needed to pay for the contributor's share of the benefit could be cashed-out with interest. This amount could also be transferred to a portability vehicle or left with the plan to increase the value of the deferred benefit, if the plan sponsor agrees.

If the terminating employee is vested and has reached age 40, available options are limited. The employee would be permitted to:

- Take a deferred pension; or
- Transfer the value of the deferred pension to a locked-in portability vehicle.

In a contributory plan, any employee contributions, with interest, not needed to pay for the contributor's share of the benefit could still be cashed-out, transferred to a portability vehicle, or left with the plan to increase the value of the deferred benefit, if the plan sponsor agrees.

Finally, an employee leaving a contributory plan before vesting would receive:

- Return of employee contributions with interest, which could be transferred to a portability vehicle.

The proposed portability provisions assume that two distinct portability vehicles will be available: one that locks-in all contributions, and one that allows cash-outs. The characteristics of the two portability vehicles are presented in Chapter VI.

To ensure that the value of deferred benefits accrued after the effective date of legislation is fairly determined, pension regulations will specify standards for valuation. These standards would recognize the minimum inflation protection requirements and would have to be revised periodically to reflect changing economic conditions. The plan's funded status would have to be considered in determining the proportion of the benefit that would be transferable.

Portability of Past Service Pension Benefits

Ontario proposes that pension benefits vested and locked-in under the terms of the current "45 and 10" rule also be made portable. This would allow both past and future terminating plan members to transfer the value of pensions accrued under present legislation to a locked-in portability vehicle. The transferred funds would then grow with investment earnings.

This proposal is advanced in full recognition that it involves an element of legislative retroactivity. However, with few exceptions, deferred members of voluntary employment

pension plans have not had any ad hoc updates of their locked-in benefits and, without this, their benefits have been eroded by inflation.[32] Allowing portability of these accrued benefits is a compromise that can improve the pension position of deferred plan members without imposing costly retroactive escalation requirements on plan sponsors. As well, plan sponsors would be free of the administrative costs of maintaining the records of members who withdrew years earlier.

Because there is no proposal for mandatory inflation protection on benefits earned before the effective reform date, the value of benefits to be transferred would be determined using standards under current legislation. As with the portability proposals that apply to benefits earned on future service, a plan's funded status would be considered in determining the proportion of the past service pension benefit that would be transferable.

Mandatory Survivor Benefits

In 1980, only 731 pension plans in Canada covering 43 per cent of all plan members provided a survivor pension as a standard benefit. The remaining 13,855 plans either offered survivor pensions as an option or provided no survivor benefit at all.[33] Where a survivor pension is the standard benefit, it is usually reduced to 50 per cent upon the death of the plan member, but remains at 100 percent if the contributor's spouse dies first. This asymmetric benefit reduction puts an unfair financial burden upon women, especially those who have been full-time homemakers.

Ontario proposes that survivor provisions be improved and better designed. Employment pension plans should be required to provide a joint and last survivor benefit, reducing to 60 per cent upon the death of either spouse. An alternative form of payment would be permitted only if both spouses agree in writing. The new benefit provision would commence with the effective date of legislation.[34]

Two additional proposals will give spouses added protection. If a vested pension plan member dies before retirement, the surviving spouse should be eligible for a survivor benefit equal to 60 per cent of the value of the member's accrued pension.[35] If the surviving spouse has reached age 40, the pension benefit would be locked-in but would be transferable. Legislation should also be amended to specify that survivor pensions provided before or after retirement should continue if the recipient remarries. Ontario recently introduced this provision into the pension plan covering the Province's civil servants.

Pensions as Family Assets

Under current Ontario legislation, only pensions-in-pay are divisible upon divorce or separation, and then only for the purposes of support. This does not recognize that marriages are cooperative partnerships and that both spouses have contributed, directly and indirectly, to the accumulation of family pension assets.

In keeping with the objectives of the *Family Law Reform Act*, it is proposed that pen-

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[32]Laurence E. Coward and J. Wells Bentley, *Study on Private and Public Sector Interpretation of Pension Escalation Issues* (Toronto: William M. Mercer Ltd., 1983).

[33]Statistics Canada, *Pension Plans in Canada 1980*, Catalogue Number 74-401.

[34]Saskatchewan requires a pension plan to provide a 50 per cent minimum post-retirement surviving spouse's pension; an alternative benefit form can be selected only if both spouses agree. Manitoba requires a pension plan to provide a two-thirds minimum post-retirement surviving spouse's pension; any alternative benefit form can be selected only if both spouses agree.

[35]Manitoba requires pension plans to provide a pre-retirement survivor benefit equal to the commuted value of the deceased employee's pension.

sions-in-pay and the value of pensions accrued be divided between spouses upon marriage dissolution.[36]

The value of pensions accrued and pensions already being paid would be split equally between spouses upon marriage breakdown, unless the courts or the parties themselves determine otherwise. While the actual division of pension assets in money purchase pension plans and pensions-in-pay would be relatively straightforward, the division of pension assets accrued in defined benefit plans can pose practical problems. For these plans, pension legislation would specify how the deferred pension benefit is to be valued. However, it would be left to the courts to decide whether it is practical to divide the deferred pension, or instead to compensate the non-pension spouse by adjusting the division of the other assets held by the family.

The final disposition of the pension assets would also be subject to the legislated locking-in provisions. If the pension asset is divisible, or if a cash settlement in lieu of a pension is agreed to, the amount must be transferred to a locked-in pension vehicle if the recipient spouse has reached age 40. If younger, the spouse may transfer the funds to a voluntary portability vehicle or receive them in cash.

Removal of Sex Discrimination

In money purchase pension plans, a male member with the same earnings and contribution history as a female member will receive a higher initial pension. This occurs because the life expectancy of females at age 65 is four years longer than that of males. However, had the plan provided a defined benefit based on earnings and years of service, male and female members with identical earnings and work histories would receive equal monthly pensions.

The paying of unequal benefits to men and women within a pension plan solely on the criterion of gender discriminates against women. Ontario proposes that equal pensions be paid to men and women who retire from a pension plan under identical circumstances.

Grouping individuals by gender to determine their risk classification for the purchase of life annuities is a long-established actuarial practice within the pension and insurance industries. The removal of sex discrimination within pension plans requires the resolution of many important issues before this principal can be effectively implemented in legislation.

For example, should the principle of equal payments apply only to normal pension benefits? Defined pensions that now pay equal benefits to male and female members offer actuarially equivalent benefit options calculated on sex-differentiated mortality tables. Should one unisex mortality table embodying the male-female composition of the Canadian population be specified, or should each pension plan be allowed to calculate its own unisex table based upon the sex composition of its membership? Would regulations have to be introduced to ensure that individual savings transferred from pension plans by mobile employees be directed towards portability vehicles that permit the purchase of life annuities calculated on unisex tables?

As well, caution must be exercised to avoid the impact of adverse selection. Male annuitants may increasingly select fixed annuities to avoid the reduction in the pension benefit caused by using unisex tables. With the passage of time, mostly women may purchase life annuities and the unisex table will begin to reflect the mortality experience of only one sex—female. The objective of removing sex discrimination would be thwarted.

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[36]Saskatchewan divides pension credits and pensions-in-pay in accordance with the terms of its family law legislation or an interspousal contract agreement. Manitoba requires pensions to be split equally between spouses without recourse to the courts or reference to alternative arrangements agreed upon by the spouses.

Ontario proposes that the federal and provincial governments, and the pension and insurance industries, examine how sex-based discrimination in pension plans can be removed with minimal disruption and adverse side-effects.

Improved Full-Time and Part-Time Employee Coverage

To enhance pension coverage, it is proposed that, where an employer-sponsored pension plan exists, all full-time employees should be eligible to participate at age 30 and after the completion of one year's service. Part-time workers with durable attachment to an employer should have the option of joining a pension plan.[37] Employers could establish a separate pension plan for part-time workers.

Full Disclosure

The Ontario *Pension Benefits Act* was amended in 1980 to require sponsors to disclose fully to members information about their plans. At least every three years, the sponsor must forward to members details of their benefit entitlements. Upon request, sponsors must also provide statistical, actuarial and financial documentation regarding the plan. For defined benefit plans, this includes a balance sheet setting out liabilities for all benefits, the value of the fund's assets and any unfunded liabilities, experience deficiencies or surpluses.

The Canadian Association of Pension Supervisory Authorities has issued a consensus document describing a uniform set of disclosure provisions.[38] Ontario's requirements are now substantially similar to the CAPSA proposals and it is recommended that the CAPSA consensus on disclosure continue to be the model for implementation of uniform disclosure provisions in both federal and provincial jurisdictions.

Representation of Plan Members

The existing exclusion of employees from most pension boards resulted from the view of pensions as rewards for long service. Pensions, however, are now considered to be deferred compensation and it is difficult to argue that employees should not be represented on the body directing the affairs of the pension plan.

Employees should be allowed to choose at least one member of the body directing the affairs of the plan, if requested by a majority. Consideration should also be given to extending to retirees the same right of representation. This would ensure that plan members participate in the operation and administration of their plan.

To avoid imposing a cumbersome administrative structure on small employers, pension plans with less than twenty members would be exempt from this requirement. Because of the close relationship between small employers and their employees, such formal employee representation would usually be unnecessary.

Use of Pension Plan Surpluses

The proposals for mandatory inflation protection, reasonable interest on employee contributions, minimum employer contributions and pension portability recognize pensions as deferred compensation. Further, the proposals for mandatory inflation protection and reasonable interest on employee contributions direct the inflationary component of invest-

[37]Manitoba requires compulsory participation of full-time employees regardless of age. Part-time employees must participate if they earn at least 25 per cent of the CPP pensionable earnings for two consecutive years.

[38]Canadian Association of Pension Supervisory Authorities, "CAPSA Consensus on Uniform Disclosure Legislation" (mimeo, 1982).

ment earnings in defined benefit pension plans towards the plan membership. This also identifies pensions as deferred compensation.

With the impact of these reforms in mind, and unless otherwise contracted with plan members, any future pension plan surpluses should continue to revert to the plan sponsor as compensation for underwriting the risk of providing a defined pension benefit. The sponsor could use the surplus to cushion the plan against future experience deficiencies, enrich plan benefits, provide more inflation protection or reduce plan costs. Disclosure provisions and representation of plan members on the body directing the affairs of the plan would ensure that the membership is aware of any surpluses. Finally, subject to the approval of the Pension Commission of Ontario, the sponsors could withdraw surpluses from their plans.

Legislation requiring future surpluses to become the property of the plan membership would be counterproductive. First, many plan sponsors now fund their plans conservatively to ensure benefit security. If they could no longer retain surpluses thus generated, they might adopt minimum funding schedules that would ensure that no surpluses materialized. Over time, this would reduce the funded status of pension plans and undermine the security of the very benefits promised. Second, the designed absence of surpluses could preclude any additional pension enrichments, whether these were offered unilaterally by the sponsor or negotiated by the employees. And third, the reversion of plan surpluses to the sponsor would provide an incentive for pursuing competitive portfolio management strategies. This is necessary if pension savings are to be allocated efficiently through the capital market.

Many sponsors have used plan surpluses to finance ad hoc inflation adjustments to the pensions of retired plan members.[39] Ontario urges that this practice be continued and extended to vested members with deferred benefits. Mandatory inflation protection would not be retroactive and it could take many years before the proposed reform is fully mature. Even with employment pension plan reform, voluntary increases provided by plan sponsors would remain the principal source of inflation protection for many years.

Special Legislation for Multi-Employer Pension Plans

Various industries, especially those with highly mobile workers (such as building and construction), have central pension plans in which any number of employers and employees may participate. Because of high labour mobility, pension plans for workers in these industries would be meaningless or impossible without special arrangements among employers. These "multi-employer" plans have typically arisen out of collective bargaining where unions have negotiated rates of contributions to a central industry-wide plan.

Although these umbrella pension plans are valuable to the participating employees, their multi-employer structure has resulted in special problems. A major problem is the absence of a guarantor or sponsor responsible for the funding of the pensions promised. The participating employers' financial obligation is limited to making the contributions as required by the collective agreement. The responsibility of Boards of Trustees is generally limited to receiving contributions, endorsing benefit levels and paying pensions.

The guarantor problem is further complicated by the ambiguous nature of promised benefits. A specific benefit level is established, based on the expected contributions and investment earnings, but the contribution rates are negotiable. Thus multi-employer plans have a dual character: they are defined benefit plans because the benefit levels are set in the expectation that they will be supported by the pension fund; they are also money pur-

[39]Laurence E. Coward and J. Wells Bentley, *op. cit.*

chase plans because the contribution rates are negotiated independent of benefit levels. To ensure that members fully understand the security of the benefits they have been promised, pension legislation must clarify the status of multi-employer plans.

Ontario proposes that pension legislation should:

- Define a multi-employer pension plan;
- Specify responsibility of, and standards for, a Board of Trustees;
- Specify action required by a Board of Trustees when a participating employer is delinquent in contributions;
- Require employee representation on the Board of Trustees;
- Clarify benefit funding priorities in ongoing and wound-up plans;
- Define service for multi-employer plan purposes and define when service is deemed to be broken; and
- Introduce special disclosure requirements for multi-employer pension plans.

The Co-ordinating Committee of the Canadian Federation of Labour has prepared draft amendments to pension legislation affecting multi-employer pension plans.[40] The Canadian Labour Congress has made substantially similar recommendations.[41] The initiatives of these two labour organizations could serve as models for improving multi-employer pension plan legislation.

[40]Canadian Co-ordinating Committee on Multi-Employer Pension Plans, "Position Paper and Proposed Amendments to the Pension Benefits Act with Respect to Multi-Employer Pension Plans" (Ottawa: mimeo, 1983).
[41]Canadian Labour Congress, "Proposals for the Regulation of Multi-Employer Pension Plans" (mimeo, 1983).

VI. Individual-Based Pension Arrangements and Tax Assistance

Individual-based pension arrangements are vital if the pension system is to have the flexibility needed to meet Canadians' changing needs. Registered Retirement Savings Plans are an attractive way for individuals to supplement pension plans provided by employers and a good alternative retirement savings vehicle for employees who work for companies that do not have pension plans. This type of pension arrangement should be updated and expanded to accommodate increased mobility in the labour force and growth in part-time employment.

To upgrade the effectiveness of the voluntary individual-based pension system, three proposals are advanced. First, a portability vehicle that locks-in transfers of pension assets should be introduced. Second, regulations covering RRSPs should be amended allowing employers to make direct contributions to employees' RRSPs. Third, a review of existing tax assistance provisions for contributions to both RRSPs, RPPs and the C/QPP should be undertaken with the objective of making them fairer.

A Locked-In Portability Vehicle

The Registered Pension Account (RPA) proposed by the federal government in its February 1984 budget is intended to serve two important functions. It would act as a portability vehicle that would accept the transfer of pension assets from employment pension plans. It would also be an administratively simple money purchase pension plan to which employers could contribute on behalf of employees. Lump-sum withdrawals would be subject to a 10 per cent penalty in addition to tax otherwise payable.

Ontario welcomes the introduction of the RPA but would like to see specific lock-in provisions that would not allow cash-outs prior to retirement except in special circumstances, such as a severe disability. This new Locked-in Retirement Account (LIRA) would ensure the effective operation of portability provisions. As with the proposed federal RPA, direct contributions by individuals, or by employers on behalf of employees, would be permitted.

The strict locking-in of contributions to LIRAs is intended to prevent the premature withdrawal of locked-in pension transfers from employment pension plans and, therefore, additional provisions for early withdrawal penalties are not required. Individuals would be able to control the investment of the funds in their LIRAs in the same way they now determine the investment of their RRSP savings. Similarly, financial institutions now competing for RRSP funds would also compete to handle pension savings in LIRAs.

On retirement, an individual would have two options available for the funds accumulated in LIRA accounts. The person may:

- Purchase an annuity, which would have to include a 60 per cent joint and last survivor benefit unless waived by both spouses; or
- Purchase a Registered Retirement Income Fund as provided for under the *Income Tax Act.*

A Redesigned RRSP

Ontario proposes that RRSPs continue in their present form, but that regulations be amended so that employers, both large and small, be allowed to contribute directly to their employees' personal RRSPs. This would make RRSPs an attractive flexible alternative for small employers to extend formal pension coverage to their employees. It would also make

it administratively easier to provide formal pension coverage for part-time workers, who are a growing component of the regular labour force.

Fairer and More Flexible Tax Assistance

Tax assistance for retirement savings should be reviewed to make treatment of different pension arrangements fairer and more uniform. This includes examining whether a tax credit approach should replace the existing deduction-based system for assisting individuals with their contributions to both voluntary pension arrangements and the mandatory C/QPP.

Ontario supports the principle of lifetime comprehensive tax assistance proposed in the February 1984 federal budget. The proposed system will ensure that individuals have equal access to tax assistance for retirement saving, irrespective of their mix of pension vehicles. Also, the proposed system allows deductions unused in one year to be carried forward to the next. However, certain aspects of the proposed scheme require further review.

The federal proposals call for a common funding factor of nine, to be used by members of defined benefit pension plans to calculate the "target contribution" necessary to buy a given pension accrual. The funding factor is the average dollar amount needed to buy a pension annuity of $1 and depends on a variety of factors, such as whether the pension is indexed, the age of the contributor and the age at which the pension starts. The federal budget proposals deem that a factor of nine is adequate for pension plans with provisions for 60 per cent survivor benefits and inflation protection of CPI minus one per cent, with retirement at age 63. Thus, an individual who belongs to a less generous pension plan than is assumed under the proposals could be deemed a higher "target contribution" than is actually necessary to buy the benefit, with a consequent reduction in the room left for additional tax-assisted retirement savings. It would be more equitable if variable funding factors were assigned to different pension plans that better reflect their actual design.

Also, the factor of nine is only appropriate for an individual who spends most of the earning years until retirement in pension plans of similar design.

Finally, the design of the new system also continues to deliver tax assistance to retirement savings in the form of deductions from income. Such a system has been often criticized for disproportionately benefitting people with higher incomes. The Parliamentary Task Force on Pension Reform has recommended the replacement of the deduction-based system with a tax credit for retirement savings contributions. Ontario proposes that closer study be made of the implications of introducing tax credits for retirement savings.

Using tax credits to ease the impact of compulsory C/QPP contributions on low-income households should also be considered. While many individuals with low earnings are exempt from paying income tax, they are still required to contribute to the C/QPP without the benefit of the tax deduction available to people with higher incomes. This will become an increasing concern as contribution rates rise. A refundable tax credit would reduce the burden of C/QPP contributions on low-income families.

VII. Cost and Impact of Employment Pension Plan Reform

Acceptance of pensions as deferred compensation, combined with assured portability of accrued pension benefits, may gradually alter the structure of Canada's voluntary pension system. Although group-based defined benefit pension plans would still be important, their relative importance would decline as an increasing proportion of retirement income was delivered through money purchase individual-based retirement savings vehicles.

Ontario's employment pension plan reforms would increase overall private sector pension costs. There would be a wide variance in the increase for individual plans, but the average increase would range between 25 and 43 per cent. Costs would vary widely among pension plans because each is affected differently by a range of variables. However, a plan's benefit escalation practice is the variable that most affects cost increases. If a plan regularly provides ad hoc inflation protection for its members, cost increases would be less.

While the percentage increase in costs can be high, the absolute level of cost increases would be manageable. Expressed as a percentage of payroll, overall costs would rise by an average of 1.8 per cent for plans that have not had ad hoc increases and 1.2 per cent for plans that have had ad hoc increases. The impact of this increase would be reduced by the tax deductibility of pension contributions. Viewed from this perspective, and recognizing that cost increases mean more and better pensions, employees and employers should be willing to cooperate in absorbing increased pension reform costs.

Cost of Employment Pension Plan Reform

Table 10 contains estimates of the long-run total cost of five types of employment pension plans expressed as a percentage of payroll before and after the introduction of Ontario's proposed reforms. The specific reforms costed are: 60 per cent inflation protection, five-year vesting, minimum employer contributions, reasonable interest on employee contributions and mandatory pre- and post-retirement survivor benefits. The initial plan designs, actuarial and economic assumptions, and costing technique are the same as those used by the Business Committee on Pension Policy (BCPP) in its seven-volume report *A Consensus Brief on Canadian Retirement Income Policy*.[42] The BCPP plan designs, database and methodology were adopted because they reflect well the actual practice followed in the private sector. Further, BCPP economic assumptions are reasonably representative of long-term forecasts and are suitable for estimating long-run cost impacts.[43]

Reform costs would vary from plan to plan because of the wide variations in benefit designs, employee turnover, valuation methods, funded status, average age of members and male-female composition of plan membership. However, for a given plan design, the major determinant of potential cost increases is a plan's established escalation practice. If a plan currently provides regular ad hoc increases in benefits to protect its members from inflation, pension reform cost increases would be lower. The actual cost increases experienced by a particular plan may differ substantially from the costs shown in Table 10. This fact must be remembered in the following analysis, which discusses costs only for the representative plans.

Pension Commission of Ontario data confirm that large plans typically escalate the pensions paid to retirees by about 40 per cent of the inflation rate.[44] As well, flat benefit and

[42]Business Committee on Pension Policy, *A Consensus Brief on Canadian Retirement Income Policy,* September 1983.

[43]The assumptions used to calculate the estimated costs in Table 10 are: *fund rate* (8.5%); *salary growth* (7.5%); and *inflation* (6.0%).

[44]Laurence E. Coward and J. Wells Bentley, *op. cit.*

Pre- and Post-Reform Cost Estimates for Private Sector Pension Plans — Table 10
(Percentage of payroll)

Plan Type	No Ad Hoc Increases: Before	After	% Change	40% Ad Hoc Increases[1]: Before	After	% Change
Money Purchase	7.6	8.0	5	7.6	8.0	5
Flat Benefit[2]	2.0	3.3	65	2.4	3.3	38
Career Average[2]	5.5	7.7	40	6.2	7.7	24
Final or Best Average (Contributory)	6.1	8.6	41	6.9	8.6	25
Final or Best Average (Non-Contributory)	3.9	6.1	56	4.6	6.1	33
All Plans Combined[3]	4.2	6.0	43	4.8	6.0	25

Source: Estimates prepared by William M. Mercer Ltd. on behalf of Ontario Ministry of Treasury and Economics.

[1]40 per cent is a typical inflation increase for pension plans provided by large employers.

[2]Assumes update of actives at 70 per cent of AIW.

[3]Weightings were based on plan membership statistics provided in the Green Paper — 8.6 per cent money purchase, 39 per cent flat benefit, 22.3 per cent career average, 17.3 per cent contributory final average and 12.8 per cent non-contributory final average.

career average plans escalate the benefits of active contributors by at least 70 per cent of changes in the Average Industrial Wage. These escalation practices are embodied in the cost estimates in Table 10.

Under the assumption that plan sponsors do not provide ad hoc inflation adjustments, the figures indicate that pension reform would mean substantial cost increases. Proposed reforms would increase the cost of flat benefit pension plans by 65 per cent, non-contributory final or best average plans by 56 per cent and career average plans by 40 per cent. Money purchase plan cost increases would be a modest five per cent. This is because these plan designs would only be affected by the proposed five-year vesting rule.[45] For all plans combined, the proposed reforms would raise private sector pension costs by 43 per cent.

However, many plan sponsors do provide regular ad hoc increases in the benefits of their retired members to compensate for inflation. This practice lowers potential cost increases. Instead of a 65 per cent increase in costs, flat benefit plans face an estimated 38 per cent increase. For non-contributory final average plans, the increase drops from 56 to 33 per cent, and for career average plans the cost increase reduces to 24 per cent. Across all plans the percentage increase in payroll cost declines from 43 to 25 per cent.

An important feature of the figures in Table 10 is that, while the percentage increases in costs are large, the cost of pension reform as a percentage of payroll ranges from 0.4 to 2.5 per cent. For example, proposed reforms would cause an average 65 per cent increase in the cost of flat benefit plans if there is no practice of granting voluntary inflation adjustments for retired members. This translates into an average payroll cost increase of 1.3 percentage points. However, most sponsors of flat benefit plans currently provide ad hoc updates; pension reform would only raise the costs of these plans by an average 0.9 percentage points of payroll. Many sponsors of career average and final average plans also grant ad hoc increases, which would reduce the impact of proposed pension reforms.

[45]Money purchase plans are unaffected by the inflation protection proposal because, by design, any inflation-induced investment earnings flow to the plan membership. However, in exchange, plan members assume the risks of their investment.

It should also be remembered that pension plan contributions are tax-assisted. Employer and employee pension contributions are deductible from income for tax purposes. This reduces the effective impact of pension reform cost increases. Government can further ease the adjustment to higher pension costs by not implementing reforms until employers and employees have had time to negotiate and arrange any necessary alterations in total compensation practices.

The value and effectiveness of any pension reform package is directly reflected in its cost. It is inescapable that if the voluntary employment pension system is to provide more and better pensions, then the overall cost of private pension plans will have to increase. If Canadians want a better voluntary pension system, they will have to accept higher pension costs.

Impact of Increased Costs

Most large and well-established employers can absorb short-run cost increases and adjust to long-run increases by accommodating increased costs internally or by negotiating lower salary and wage increases. Because of mandatory inflation protection, employers and employees may agree to reduce pension plan benefit formulae to offset cost increases, or in some cases to keep overall pension costs unchanged. With these redesigned benefits, starting pensions would be lower but the dollar amount would increase with inflation in later years.

Smaller employers, less well-established ones or those in economic sectors experiencing difficulties would have to consider a wider spectrum of options. These employers may replace defined benefit plans with money purchase plans, or possibly even discontinue plans. In this last case, the responsibility for voluntarily providing for retirement would then rest with individual employees through LIRAs and RRSPs.

The chief long-run cost for small and medium-sized employers would be inflation protection. Some of these employers may decide that, even after possible reductions in their plan's benefit formula, minimum inflation protection would still expose their companies to an unacceptable amount of uncertainty about cost fluctuation because of unexpected increases in inflation. Their response would be to replace defined benefit plans with money purchase plans.

While pension reform will cause many employers to re-evaluate their pension plans, and some to wind down their plans, reform will also make pension plans more attractive to employees. This could lead to more employee willingness to negotiate for, and participate in, employer-sponsored pension plans. This is particularly true for short-service workers who are largely disadvantaged by existing employer-sponsored pension arrangements. As well, mandatory eligibility for full-time and part-time workers will increase pension coverage.

In summary, increased costs could cause some reduction in defined benefit formulae, a replacement of defined benefit plans with money purchase arrangements and the possible wind up of some plans. While it is not possible to project the extent of these changes, they will probably not be significant if employees and employers are given sufficient time to adjust to increased pension costs. At the same time, the pension system will become more attractive to short-service and part-time workers. This will increase participation in existing pension plans, and possibly lead to the introduction of more plans. It should be remembered that the most rapid growth in voluntary employment pension plans occurred following the introduction of legislation in 1965 specifying minimum pension plan standards.

Impact of Pensions as Deferred Compensation

The pension system will have to adapt to the recognition that pensions are deferred compensation and belong to employees. Acceptance of pensions as deferred compensation

may alter the structure of Canada's voluntary retirement system. Over time, an increasing proportion of retirement income will be delivered through individual-based money purchase pension vehicles, which will correspondingly reduce the relative importance of defined benefit pension plans.

Ontario's proposed employment pension reforms incorporate the view of the majority of Canadians that pensions are deferred compensation:

- Vesting after five years of service means that workers can change employers without losing their accrued pension benefits;
- Reasonable interest on refunds of contributions acknowledges that an individual employee's contributions held by a pension plan belong to that employee and should not be used as a mechanism for subsidizing the benefits of other employees;
- Minimum employer contributions assure that the accrued pension benefits of short-service as well as long-service workers are at least partly financed by the employer, as is generally understood by the membership of "contributory" pension plans;
- The provision of minimum inflation protection for defined benefit plans recognizes that inflation-induced investment earnings generated by pension savings of a plan's membership should be used to finance benefit escalation, and not be redistributed from retired and deferred members to the active membership as benefit formula enrichments, or to the plan sponsor as lower costs; and
- Assured portability allows workers to accumulate in individually owned vehicles the pensions that have been accrued in various employment-based plans.

The shift to a more individual-based system will occur in three ways.

First, earlier vesting combined with improved portability will permit mobile employees to accumulate in their individual LIRAs and RRSPs the value of benefits transferred from various defined benefit plans. Defined benefit plans will still outnumber employer-based money purchase pension plans, but with labour mobility, an increasing proportion of retirement income will originate from these new money purchase-based pension vehicles.

Second, many employers will review and redesign their pension plans. To accommodate society's view that pensions are deferred compensation and also to satisfy the desire to reward long-service employees, some employers could replace a single pension plan with a two-tiered system. For example, an informally indexed contributory two per cent final average plan could be replaced by a 60 per cent indexed non-contributory 1.5 per cent final average plan with benefits beginning to accrue only after an employee reaches age 30. This first tier would benefit long-service employees and lessen the cost impact of specific pension reforms — earlier vesting, minimum employer contributions, reasonable interest on refunds, inflation protection and the required portability of vested benefits.

The second tier could be a contributory money purchase arrangement for which all part-time and full-time employees, regardless of age, would be eligible. The money purchase plan, or direct employer contributions to RRSPs and LIRAs, would explicitly recognize pensions as deferred compensation and allow the employer with high employee turnover to limit administrative costs, especially on the coverage of part-time workers. This type of two-tier pension plan restructuring will increase the number and proportion of short- and long-service employees participating in money purchase pension plans and Canada's overall voluntary retirement system will become more money purchase-based.

Third, the redesigned RRSP will extend the availability of formal pension coverage to the nearly three million part-time and full-time employees working for small firms. Comprehensive lifetime tax deductions for pension contributions will also serve to enhance the impact of the more flexible RRSP. These two reform initiatives would also lead to an in-

creasing proportion of retirement pensions originating from individual-based money purchase vehicles.

The Ontario Government has accepted and endorsed the fundamental premise upon which the Royal Commission on the Status of Pensions in Ontario based their recommendations. The Commission's recommendations were predicated on the view that the majority of Canadians believed that retirement planning was the responsibility of the individual. Specifically, the Report stated:

> There is general agreement that retirement is an individual matter and that ultimately the individual is responsible for his or her own retirement. . . Individual needs and desires require flexibility which cannot be given by group programs or universal social programs.[46]

Ontario's proposals should be understood, therefore, as accommodating the transformation of Canada's voluntary pension system to more individual-based pension arrangements.

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[46] *Report of the Royal Commission on the Status of Pensions in Ontario,* "Design for Retirement", Volume I (Toronto: Queen's Printer, 1980).

VIII. Women and Pensions

Canada's current pension system has various limitations that unintentionally make it difficult for some women to prepare adequately for retirement. The Royal Commission on the Status of Pensions in Ontario observed that, although retirement arrangements are not inherently discriminatory against women, their design and operation often result in women obtaining minimal retirement income.[47]

Ontario has proposed many reforms that will enable the pension system to meet the needs of women, not only as homemakers but also as primary and independent income earners. These reforms will improve the retirement income position of women significantly. Measures of the quantitative impact pension reform will have on women are presented in Appendix A.

Various groups have proposed the introduction of a special CPP pension to provide homemakers with direct retirement income security. However, the specific proposals that have been advanced all create problems and inequities. The federal and provincial governments will be studying homemaker pension proposals to determine whether a specialized provision can be equitably incorporated into the CPP; as well, alternatives to direct homemaker pensions will be examined.

Pension Problems Faced by Women

Many women find that a variety of social and economic circumstances impede their accumulation of adequate retirement income. Most of their pension difficulties stem from the characteristics of female participation in the labour force. Until recently, women have tended to be employed by small firms, work part-time or have interrupted job attachment, and as a consequence have had low earnings. As a result, many women have jobs that do not offer them formal pension coverage other than the compulsory Canada Pension Plan.

Where women are covered by an employer-sponsored pension plan, their high level of mobility reduces the probability that they will satisfy the minimum vesting provisions to qualify for a pension benefit. Leaving the labour force to raise young children is another obvious impediment to the accumulation of continuous pensionable service. Even if a woman is eligible for a deferred pension when she leaves an employer, her frequently low earnings combined with poor portability provisions and the general absence of pension escalation will significantly reduce the value of the pension eventually received.

Canada's existing pension system does not fully recognize that pension assets and credits accrued during a marriage or common-law relationship are jointly owned by both spouses. As a consequence, the treatment of pensions on marriage breakdown is inconsistent and often inequitable. This has worked to the disadvantage of women, who find that they do not benefit from pensions earned during the marital relationship.

For many older women, and for a significant but declining number of younger women, well-being in retirement may depend upon the existence of survivor benefits in their spouses' pension plans. However, many employment pension plans do not offer survivor benefits and this results in a significant drop in a woman's income when her spouse dies. Even where a survivor pension is available, the lack of inflation protection undermines the real value of the remaining benefit. Without other sources of private income, many women become dependent upon the federal government's income-tested GIS program and provincial top-up programs, such as Ontario's GAINS.

[47]See *Report of the Royal Commission on the Status of Pensions in Ontario,* Volume III, p. 115.

Impact of Pension Reform on Women

Ontario's pension reform proposals are designed to help solve the pension problems faced by women, and provide them with better pensions. This will be achieved by:

- Raising the OAS/GIS/GAINS guarantee for the single elderly;
- Ensuring that employment pension plans and the CPP accommodate the dynamic and varied labour force characteristics of women;
- Improving the opportunities for women to prepare for retirement through changes to RRSPs, the introduction of a LIRA and more flexible tax assistance for retirement savings;
- Recognizing pensions as family assets by splitting pension credits and assets upon breakdown of marital relationships and dividing CPP pensions at retirement; and
- Improving survivor benefits in employment pension plans and the CPP.

Many of the problems of today's elderly cannot be solved solely by reforms to Canada's earnings-related public and private pension system. However, the reforms will ensure that fewer women will be dependent upon government income-tested programs in the future. Ontario's increase of the singles guarantee under the federal-provincial OAS/GIS/GAINS system recognizes that improving the incomes of today's retired elderly is a reform priority. Ontario GAINS payments will be raised so that the overall OAS/GIS/GAINS singles guarantee will be at least 60 per cent of the income guaranteed elderly couples. By the end of 1984, the single elderly in Ontario will be guaranteed a basic annual income of over $8,000. The increased GAINS guarantee will benefit the 124,000 elderly in Ontario with the lowest incomes, most of whom are women.

Because of their high labour mobility, women have borne a disproportionate share of the inequities in existing private pension plan designs. The introduction of earlier vesting, reasonable interest on employee contributions, minimum employer contributions, inflation protection and improved portability would ensure that employment pension plans treat women more fairly by better accommodating their changing work patterns.

Indeed, because proposed minimum pension provisions are intended to treat short-service workers fairly and because women tend to stay with employers for shorter periods of time, they will benefit proportionately more from employment pension reform than will men. For example, it is estimated that if a woman joins the Ontario Public Service Plan at age 30, pension reform will increase her expected retirement benefit by 27 per cent. For a 30-year-old man joining the plan, the comparable increase is only 15 per cent.

The proposed requirement that part-time employees be given the option of joining an employment pension plan at age 30 will improve women's opportunity to prepare for retirement. This proposal will be of particular benefit to women because they comprise over 70 per cent of Canada's 1.5 million part-time workers.[48] It will be an increasingly important benefit to women in the future because the growth rate in the number of female part-time workers exceeds that of males.[49]

The proposed reduction in the CPP's contributory period from 40 to 35 years also better accommodates the working patterns of women. Women's CPP pensions will be less

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[48]Labour Canada, *Part-time Work in Canada; Report of the Commission of Inquiry into Part-time Work* (Ottawa: Department of Supply and Services, 1983) pp. 45, 198.

[49]Ontario Ministry of Treasury and Economics, Pension Policy Unit, *Part-time Employment in Canada: Summary of Demographic Trends 1955-1982* (Toronto: mimeo, 1982).

affected by their longer periods out of the paid labour force, part-time work and lower earnings. It is expected that the reduced contributory period will raise CPP pensions for women by an average of 10 per cent.

The proposals to introduce a LIRA and to allow employers to contribute directly to employees' RRSPs would be of particular benefit to women who work for small employers. The low administrative costs of these individual-based money purchase pension plans will encourage small firms to establish such plans on behalf of their employees, both full-time and part-time. Their employees, both male and female, will still have the option of making supplementary earnings-related contributions to their LIRAs and RRSPs. The LIRA, in combination with earlier vesting and portability rights, would provide women with a mechanism for accumulating pension benefits earned while working for many different employers, whether large or small.

The federal proposal to increase tax deductions on pension savings and to provide more flexible tax assistance arrangements gives women and men a better opportunity to tailor the timing and pattern of the retirement savings to their savings priorities. People who need their earnings to raise a family and want to defer accrual of pension savings would have the flexibility to do so. The federal tax proposal permits individuals to accumulate retirement savings tax assistance so that it can be used in later years when family responsibilities are fewer, more income is available for saving and retirement preparation is a priority.

Ontario's employment pension plan reform proposals recognize that marriages are co-operative partnerships with both spouses contributing, either directly or indirectly, to pension and retirement savings. In ongoing marital and common-law relationships, the mutual contributions of spouses to the accrual of CPP credits are explicitly recognized by the proposal that pension credits be automatically split between partners when the younger spouse reaches age 65. This means that spouses who have not directly contributed to the CPP because they have chosen to be full-time homemakers will receive a pension in their own right.

Ontario's proposal to divide private pension assets and CPP credits on all forms of marital breakdowns incorporates the principle that both spouses have made mutual contributions to a family's retirement savings. This recognizes that both partners have contributed towards the pension, either directly or indirectly. The immediate division of assets and credits also eliminates the difficulties in trying to locate spouses who were divorced many years earlier in order to divide their pension payments.

This need for change is underscored by Canada's increasing divorce rate. Since 1966, Canada's divorce rate has risen fivefold from 50 to 250 divorces per 100,000 population, following revisions to the federal Divorce Act.[51]

The proposal that voluntary employment pension plans be required to provide a 60 per cent joint and last survivor post-retirement benefit recognizes that many women who choose to be homemakers should be protected in the probable event that they are predeceased by their husbands. In 1980, only 731 plans, covering 43 per cent of pension plan members, had survivorship provisions. This proposal will potentially benefit over two million spouses and, combined with earlier vesting and minimum inflation protection, will ensure that employment pension plans deliver better benefits for surviving spouses, the majority of whom are women. In addition, the proposal that private pension plans provide a 60 per cent pre-retirement survivor provision will also benefit women.

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[50]Numerical examples relating to the CPP in this chapter assume that the CPP has been in operation for 47 years so that benefits are calculated on the basis of a mature CPP.

[51]D. C. McKie, B. Prentice and P. Reed, *Divorce: Law and the Family in Canada* (Ottawa: Department of Supply and Services, 1983).

Ontario has also proposed that CPP post-retirement survivor pensions be raised to ensure that the survivor receives 80 per cent of the CPP income flowing into the household before the death of the spouse. For a survivor who did not contribute directly to the CPP, the maximum CPP benefit would be increased to $310 per month from $232.50.

Similarly, Ontario has proposed improvements in CPP pre-retirement survivor benefits that would significantly help those women who are predeceased by their spouses. The maximum monthly pre-retirement benefit for survivors aged 55 to 64 would be raised from $229.18 to $502.50. Increased survivors' pensions for those aged 35 to 54 are also proposed. Women will be the major beneficiaries of these improvements. In 1983, 92 per cent of the more than 300,000 individuals receiving CPP pre-retirement survivor pensions were women.[52]

In both the CPP and private pension plans, survivor benefits will no longer be discontinued on remarriage. This will affect over 3,000 CPP recipients each year, of whom nearly 80 per cent are women. The provision will also benefit recipients of private sector survivor pensions who would otherwise have had their benefit stopped when they remarried.

Finally, Ontario's proposal that equal pensions be paid to people in identical circumstances removes sex discrimination in money purchase pension plans. This ensures that women and men with the same earnings and contribution history receive equal levels of retirement income.

Homemaker Pensions

A number of proposals have been put forward, most recently by the Parliamentary Task Force on Pension Reform, to provide separate CPP pensions for homemakers to ensure their retirement security. By imputing a particular monetary value to homemaking services — say one-half of the YMPE — full-time homemakers would earn pensions that would be payable at age 65. While such a CPP homemaker pension could be designed, its operation would require acceptance of numerous serious inequities that would be unfair to plan members.

Various problems and inequities have been cited.[53] With a CPP homemaker benefit based on the above design, the non-earning spouse of a single-earner couple would be credited pension benefits for providing homemaker services. However, the single earner with no spouse would not receive any supplemental CPP credits in recognition for self-provided homemaker services. The inequity of not recognizing the value of self-provided homemaker services would be compounded by those high-income single-earner households that accrue a CPP homemaker pension but actually employ housekeepers to perform the household duties. Even with the single-earner couple, a benefit inequity would occur when the homemaker services are provided in part or completely by the spouse who earns the cash income.

One-earner and two-earner couples would also be treated unfairly by a CPP homemaker pension. For instance, if two spouses each earned half of the YMPE, they would receive a total CPP retirement pension in 1984 equal to $387.50 per month. A single-earner couple at the YMPE would also receive a $387.50 monthly CPP pension. But the one-earner couple would also receive an additional homemaker pension calculated at half the

[52] *Canada Pension Plan Statistical Bulletin*, Volume 15, Number 2 (Ottawa: Department of National Health and Welfare, June 1983), pp. 32-4.

[53] See, for example, *Better Pensions for Canadians*, Green Paper (Ottawa: Department of Supply and Services, 1982), p. 33; *Report of the Parliamentary Task Force on Pension Reform* (Ottawa: Queen's Printer, 1983) Dissenting Opinion by Ted Miller, M.P., pp. 149-150; Minority Report to the Minister of National Health and Welfare, "More Effective Participation of Homemakers in the Canada Pension Plan" (Ottawa: mimeo, March 1983).

YMPE, or $193.75 per month. This would bring the monthly pension of the one-earner couple to $581.25, which would be higher than that available to the two-earner couple with the same pre-retirement earnings history.

With the splitting of retirement pensions between the spouses, the inequitable treatment of one-earner and two-earner couples would spill over into survivor pensions. The survivor of the two-earner couple would receive a benefit equal to 80 per cent of the CPP income originally flowing into the household, or $310 a month. But with the additional homemaker pension, the survivor of the one-earner couple would receive a higher monthly pension of $387.50, even though both households had the same pre-retirement earnings history.

Although desirable because of the additional direct pension security a special CPP homemaker provision would provide, the specific proposals advanced to date would create serious inequities. As well, the proposals do not take into account family patterns where the incidence of single-earner families is declining. Ontario's pension reform proposals recognize that the retirement income security of full-time homemakers is probably most fairly achieved by ensuring accumulated pension assets and credits are shared between spouses.

Marriages and common-law relationships by their very nature result in couples sharing and arranging their resources for their mutual benefit over their working and retirement years. Ontario's proposals for automatic splitting of CPP benefits at retirement, increased pre- and post-retirement CPP survivor benefits, mandatory minimum survivor benefits in private pension plans and continuation of survivor benefits after remarriage will benefit full-time homemakers. In the event of breakdown in the marital relationship, better splitting of CPP credits accumulated during marriage and the treating of private pensions as family assets will ensure that spouses, including those who are full-time homemakers, share in retirement savings that have been mutually accumulated. This approach to providing retirement security for full-time homemakers, albeit indirect, would be more equitable.

Homemaker pensions and their relationship to other CPP benefit and financing proposals are complex and will require further study before final conclusions can be reached. Federal and provincial governments will be studying homemaker pension proposals to determine whether they can be equitably incorporated into the CPP. Alternatives to direct homemaker pensions will also be examined.

Conclusion

Reforms to Canada's retirement income system have been examined and analyzed for almost a decade. It is now time for the federal and provincial governments to meet and negotiate a comprehensive and uniform package of public and private sector pension reforms. These negotiations should be based on the consensus that there must be a balance between mandatory programs and voluntary pension arrangements. This means that pension reform should not only be designed to increase retirement income, it should also ensure that Canadians have a high degree of flexibility to make their own voluntary and private arrangements for retirement income that reflect their own values and priorities.

Pension reform is a dynamic process and as Canadians move towards the final resolution of issues that have consensus, it will still be necessary to continue the dialogue on the future directions of retirement income policy. Issues that will require discussion include homemaker pensions, how best to enrich CPP survivor benefits, how to finance CPP benefits and whether tax credits should replace deductions for retirements savings.

Glossary of Technical Terms

1. Government Income Transfer Programs

Old Age Security (OAS):

Federal program providing a universal, flat-rate pension to eligible residents aged 65 and over, regardless of need.

Guaranteed Income Supplement (GIS):

A monthly payment under the federal Old Age Security Act to needy recipients of the OAS pension, based on a guaranteed minimum income amount.

Guaranteed Annual Income System (GAINS):

An Ontario government program providing monthly income supplements to certain needy residents, based on a guaranteed monthly income. GAINS-A benefits apply to those aged 65 and over; GAINS-D benefits are for the blind and disabled.

2. Canada and Quebec Pension Plans (C/QPP)

Year's Maximum Pensionable Earnings (YMPE):

Term used in Canada Pension Plan, often referred to as the *earnings ceiling*: the maximum amount of annual earnings from employment on which CPP contributions and benefits are calculated. YMPE is changed each year according to a formula based on average wage levels. In 1984 the YMPE is $20,800. See also: *Replacement Rate.*

Replacement Rate:

The rate (currently 25 percent) applied to the average three most recent YMPEs in computing the benefits on retirement. The objective of the CPP is to provide a benefit replacing 25 percent of the Average Industrial Wage.

Child-Rearing Drop-out:

Provision in Canada and Quebec Pension Plans under which allowance is made for months in which no (or low) contributions were made while the contributor was raising children under the age of seven.

Credit-Splitting:

A provision in the Canada and Quebec Pension Plans whereby one spouse, on dissolution of marriage, may obtain an equal division of pension credits earned by one or both partners during the period of marriage.

Benefit-Fund Ratio:

The ratio of the size of the CPP fund in the current year to the total benefits expected to be paid out of the fund three years hence.

3. Types of Pension Plans

Defined Benefit Plan:

A plan that defines the pension to be provided (based on service, average earnings, etc.) but not the total contributions. If plan is contributory, the rate of employee contribu-

tions may be specified, with the employer paying the balance of cost. To be distinguished from *Defined Contribution Plan.*

Defined Contribution (Money Purchase) Plan:

A plan that defines contributions to be made by employer and employees, but not the benefits formula. Accumulated contributions and interest are used to purchase an *annuity* for the member. To be distinguished from *Defined Benefit Plan.*

Contributory Plan:

A pension plan that requires both employers and employees to make contributions by payroll deduction in order to qualify for benefits under the plan.

Non-Contributory Plan:

A pension plan in which all required contributions are made by the employer.

Employment Pension Plan:

A pension plan offered by an employer or supported by a group of employers for the benefit of employees. The term includes plans covering employees of governments and the private sector, but does not include the Canada Pension Plan or other public programs.

Career Average Plan:

A defined benefit plan that applies the unit of benefit to earnings of the member in each year of service, and not to the final or final average earnings.

Flat Benefit Plan:

A defined benefit plan that specifies a dollar amount of pension to be credited for each year of service.

Final Pay Plan:

Term commonly used for any pension plan whose benefits are based on earnings in a member's last years of service.

4. Pension Plan Provisions

Pension Benefits Act (PBA):

Ontario's legislation regulating employment pension plans. It specifies minimum benefit provisions, funding and solvency requirements and investment guidelines.

Portability:

Extent to which an individual is provided on retirement with pension income that recognizes all periods of employment with various employers. See also: *Vesting.*

Vesting:

The right of an employee, on termination of employment, to part or all of his or her accrued pension; usually requires *locking-in* of employee's contributions at some point. Vesting is usually in the form of a deferred annuity commencing at retirement age.

Statutory Vesting:

This occurs when employee meets the age and/or service conditions set out in pension benefits legislation. (In Ontario, statutory vesting and locking-in is at age 45 and 10 years'

service or plan membership and applies to benefits accrued within the province after January 1, 1965.)

Locking-In:

Requirement under legislation that pension contributions made after a certain date cannot be withdrawn or otherwise forfeited if the employee on termination of employment has attained a certain age or has completed a certain period of service or plan membership.

Deferred Vested Pension (Annuity):

A specified pension determined at the time of termination of employment or termination of a plan but not payable until some later date, usually normal retirement age. See also: *Vesting.*

Mortality Table:

A table showing rates of death at various ages for people born in various periods. Used by actuaries to arrive at mortality assumptions when estimating the cost of pensions for a group.

Morbidity:

A term describing the relative incidence of disease or disability in a population.

Unisex Mortality Table:

A mortality table in which estimates of death rates for males and females are combined in a single table.

Excess Interest Earnings:

In discussion of inflation, earnings from investment of a pension fund in excess of an assumed or expected rate of return.

Accrued Pension:

Amount of pension credited to a plan member according to service, earnings, etc., up to a given time.

Joint and Last Survivor Annuity/Benefit:

An annuity/benefit payable as long as one spouse is alive. May be available as a level amount or with a reduction when one beneficiary dies.

Active Members:

Employees currently working and members of a pension plan.

Deferred Members:

Terminated employees eligible for a deferred vested pension. See also: *Deferred Vested Pension.*

Registered Retirement Income Fund:

Form of investment vehicle alternative to an annuity, permitted under the *Income Tax Act* for funds an individual has accumulated in a Registered Retirement Savings Plan that

has "matured". Payouts can commence any time after age 60 but before age 71 and are calculated such that the fund reduces to zero in the year of the individual's 90th birthday.

5. Funding

Pay-As-You-Go:

Term used for benefits that are not funded except as and when they are paid to individuals; i.e., payment is made from current revenue or other sources outside the plan as such.

Funding:

Systematic payments into a fund that, with investment earnings, are expected to provide for all pensions and other benefits as they become payable.

Fully Funded:

Term describing a plan that, at a given time, has sufficient assets to provide for all pensions and other benefits in respect of service up to that date.

Unfunded Liability:

Generally, any amount by which the assets of a pension plan are less than its liabilities.

Experience Deficiency:

An unfunded liability, revealed by an actuarial review of a pension plan, resulting from a difference between actual experience (investment earnings, salary levels, etc.) and assumptions made at the time of a previous valuation.

Surplus:

If a pension plan's assets exceed the plan's total liabilities, the difference is called a surplus.

Amortization Period:

Period of years over which payments are made into a pension plan to meet the cost of benefits that have not been fully funded. An unfunded liability, for example, must be amortized over 15 years, an experience deficiency over five years.

6. Pension Organizations

CAPSA:

Canadian Association of Pension Supervisory Authorities is made up of the senior government officials in charge of the administration of pension legislation of each jurisdiction with pension benefits legislation (i.e., Ontario, Alberta, Manitoba, Saskatchewan, Quebec, Nova Scotia, Newfoundland and the federal government). Representatives from other interested provinces may attend the meetings.

Canada Pension Plan Advisory Committee:

The Committee is composed of not more than 16 members representative of employees, employers, self-employed persons and the public. Its duty is to review periodically the operation of the Act, the state of the CPP Investment Fund and the adequacy of coverage and benefits under the Act and to report its results annually to the Minister of National Health and Welfare.

Appendix A

Quantitative Impact of Pension Reform on Women

Ontario's reform proposals ensure that the pension system will better accommodate the characteristics of women's labour force participation and this will improve their pension income. This appendix provides quantitative measures of how the proposed changes to employment pension plans and the Canada Pension Plan will benefit women.

Employment Pension Plan Reforms

Earlier vesting, reasonable interest on employee contributions, minimum employer contributions and inflation protection will significantly improve the effectiveness of voluntary employment pension plans. Although these reforms will affect both short- and long-service employees, short-service employees will benefit proportionately more.

Table A1 compares the termination experience of males and females by age of entry into the Ontario public service. The figures in the table are based upon the recent experience of Ontario's 75,000 male and female civil servants and is typical of employers with a work force exhibiting low to medium levels of employee turnover.

Male and Female Work Patterns in the Ontario Public Service — Table A1

100 Individuals Enter At Age	Expected Number After 5 Years		Expected Number After 10 Years		Expected Number At Age 65	
	Men	Women	Men	Women	Men	Women
20	42	36	29	18	—	—
30	65	49	56	35	21	9
40	74	62	65	51	32	19
50	76	68	58	49	42	31

Source: Estimates provided by the Ontario Ministry of Government Services, Actuarial Services Branch.

The figures illustrate that women, on average, stay with an employer for shorter periods of time than men. For example, for every 100 women who join the Ontario public service at age 20, only 36 are still with the government after five years and only 18 are working after ten years. In contrast, of every 100 men who join at 20 years of age, 42 are still with the government after five years and 29 after ten years. The same pattern of higher female labour mobility exists at later entry ages.

The differences in male and female work patterns are also revealed by the number of individuals staying with one employer until retirement. Of 100 males who enter Ontario's public service at age 30, only 21 remain until they retire. For females, the number staying in the public service to age 65 is only nine out of 100.

Since women are more likely than men to be short-service employees, women will benefit proportionately more from the four basic employment pension reforms. The proposed five-year vesting rule "captures" proportionately more pensionable service from highly mobile employees. The other three reforms — reasonable interest on employee contributions, minimum employer contributions and inflation protection — make the captured pensionable service more valuable.

Table A2 presents the estimated impact of employment pension plan reforms on the expected income replacement provided by Ontario's Public Service Superannuation Fund (PSSF) at age 65 for men and women. The "before reform" benchmark figures exclude early retirement provisions and the escalation of post-retirement or deferred pensions. The

Increases in Expected Income Replacement Ratio in the PSSF at Age 65 — Table A2

Entry Age To The Plan		Expected Income Replacement Before Reform	Expected Income Replacement After Reform	Actual Increase	Percentage Increase
		(%)	(%)	(%)	(%)
20	Men	6.5	9.8	3.3	51
	Women	3.0	5.9	2.9	97
30	Men	14.0	16.1	2.1	15
	Women	7.4	9.4	2.0	27
40	Men	14.5	16.2	1.7	12
	Women	10.0	11.7	1.7	17
50	Men	9.1	10.6	1.5	16
	Women	7.2	8.9	1.7	24

Source: Estimates provided by the Ontario Ministry of Government Services, Actuarial Services Branch.

"after reform" figures reveal the cumulative impact of the four reforms on expected income replacement rates at age 65, by sex and age of entry into the plan. The PSSF is a two per cent annual accrual plan that, together with the CPP, provides a maximum 70 per cent pension calculated on the average of an employee's best five years.

The figures in Table A2 demonstrate the impact that different work patterns have on the expected income replacement ratio available from a particular pension plan before and after reform. Because men tend to stay longer with a given employer than do women, they have a correspondingly higher expected income replacement ratio. Before reform, a male entering the Ontario public service at age 30 will, on average, earn a pension equal to 14 per cent of his final earnings. However, a women entering the plan at the same age can expect to receive only a 7.4 per cent pension.

With the implementation of Ontario's proposed employment pension plan reforms, both men and women will realize an increase in pension income from a given employer, with women benefitting proportionately more. For example, at entry age 30, the expected replacement ratio for females will rise from 7.4 to 9.4 per cent, for a proportionate increase of 27 per cent.The corresponding proportionate increase for males is 15 per cent. Due to their higher turnover, women will still have lower expected income replacement ratios than men from any given pension plan, even after pension reform.

Two important caveats must be stressed with respect to the figures in Table A2. First, the figures portray only the average income replacement ratio of individuals joining the PSSF at particular ages; they do not measure the ultimate level of retirement income available to members of the example plan. Employees leaving before retirement age would be able to transfer the value of their pension to a LIRA, an RRSP, or perhaps transfer service to their next employer. In this way, mobile workers, both male and female, can accumulate pension credits over a number of jobs and this will add up to replacement ratios that are higher than those portrayed in the table.

Second, while Table A2 indicates that, even after pension reform, males will have income replacement ratios that are consistently higher than those of females, this difference is expected to diminish over time. Women's work patterns are undergoing a rapid and steady transformation, and to the extent that male and female work patterns coincide, this will be reflected in income replacement ratios that will approach those of male pension plan members.

Normal Form of Post-Retirement Death Benefit, 1980				Table A3
	Plans		Members	
Benefit Form	No.	%	No.	%
Survivorship Pension	731	5.0	1,918,186	42.9
Option Chosen	291	2.0	49,368	1.1
Life Payments with Minimum Guarantee	11,667	80.0	1,391,727	31.1
Employee and/or Employer Contributions Less Pension Paid	450	3.1	330,049	7.4
No Benefit	1,378	9.4	581,675	13.0
Other	69	0.5	204,424	4.6
Total	14,586	100.0	4,475,429	100.0

Source: Statistics Canada, *Pension Plans in Canada 1980*, Catalogue Number 74-401.
Figures may not total 100 due to rounding.

Mandatory Post-Retirement Survivor Benefits

Table A3 reveals the type and distribution of the normal form of post-retirement survivor benefits available to members of employment pension plans in 1980. Only 731 plans, or 43 per cent of pension plan members, had survivorship pensions as the normal benefit. A total of 291 plans, covering about 50,000 members, had no pre-determined normal benefit. In these plans, each member upon retirement would have the option of choosing the benefit design, including a survivorship provision.

Life annuities with minimum guarantee periods were the normal form for 11,667 plans covering 31 per cent of all members. If the participant died before the end of the guarantee period, the full pension would continue to the surviving spouse until the end of the guarantee period, at which time it would stop. If the participant died after the guarantee period, the surviving spouse would receive no further benefits from the plan.

Many, if not most, of these 11,667 plans also allowed retiring members to convert their normal benefit form to an alternative pension design, including those with a survivorship provision. The election of a survivorship provision involves an actuarial reduction of the participant's initial benefit in order to provide a continuing benefit to the spouse after the participant's death.

Another 450 plans, covering seven per cent of plan members, simply returned to the surviving spouse the value of employee and/or employer contributions less the pension paid. The older the deceased participant, the smaller would be the refund to the survivor. Finally, 1,378 plans, covering 13 per cent of plan members, provided no post-retirement survivor benefit. An additional 69 plans provided other types of benefits upon the death of the participant.

While the figures in Table A3 do not embody the impact of the recent amendments to the Pension Benefits Acts of Saskatchewan and Manitoba, they still indicate the need to require pension plans to offer a mandatory joint and last survivor pension as the normal benefit form. Using 1980 figures, this change in pension legislation would extend survivorship pension coverage to as many as 2.5 million spouses.

This mandatory option could be exchanged in favour of another benefit option only if both spouses agreed to the change in writing. Thus, couples with at least one spouse participating in a pension plan could jointly select the pension design that best suited their cir-

cumstances. Because men generally predecease their wives, the acceptance of the mandatory survivorship option would principally benefit women. Consequently, in the future, fewer women will have to apply for income-tested government supplements after the death of their husbands.

Most of the current survivorship pensions provide the spouse with only 50 per cent or less of the plan member's initial benefit. The additional requirement that survivor pensions be at least 60 per cent of the member's pension means that many of the spouses now covered by survivor pensions will also benefit from the increased survivor pension.

Continuation of Survivor Benefits Upon Remarriage

Table A4 indicates the impact of continuing CPP survivor benefits on remarriage. During the five-year period 1978 to 1982, over 17,000 CPP recipients had their survivor benefits discontinued because they remarried. The immediate impact of continuing survivor pensions is the reinstatement of benefits for individuals whose pensions have already been terminated. The future impact will be the uninterrupted payment of survivor benefits to recipients who remarry, currently about 3,400 persons annually.

Termination of CPP Survivor Benefits — TABLE A4

Total Terminations 1978-82

Year	Number
1978	3,346
1979	3,414
1980	3,579
1981	3,721
1982	3,326
Total	17,386

Terminations by Sex, 1982

	Number	Per Cent
Male	709	21.3
Female	2,617	78.7
Total	3,326	100.0

Terminations by Age, 1982

	Number	Per Cent
under 40	589	17.7
40 to 64	2,108	63.4
65 or over	629	18.9
Total	3,326	100.0

Source: Unpublished data provided by the Income Security Programs Branch, Health and Welfare Canada.

Women will be the principal beneficiaries of continued survivor benefits. In 1982, 78 per cent of the 3,326 recipients who had their CPP survivor pensions discontinued were women. Figures in Table A4 also indicate that 82 per cent of the remarried survivors are aged 40 or older. This suggests that older women will be most affected by this proposal. While similar data are not available for employment pension plans, it is expected that the proposal to continue survivor benefits in private plans will also have the largest impact on women.

Division of Pension Assets and Credits

Direct quantitative estimates of the impact on women of dividing the value of employment pension plan assets or CPP pension credits between spouses are not available. However, the importance of this reform initiative is underscored by a marked increase in the frequency of divorce following the 1968 revision to the federal Divorce Act. Since 1966, Canada's divorce rate has quintupled, from about 50 divorces per 100,000 population to 250 per 100,000 in 1979. This translates into over 60,000 divorces annually. About three-quarters of divorced women and five-sixths of divorced men subsequently remarry.[1]

[1]D.C. McKie, B. Prentice and P. Reed, *Divorce Law and the Family in Canada* (Ottawa: Department of Supply and Services, 1983).

Benefit Impact of 25 Per Cent General CPP Drop-Out[1]	Table A5
Contributor Age 20 in 1980	**Expected Percentage CPP Benefit Increase**
	(%)
Male	3.0
Female	10.0
Combined	**6.0**

Source: Estimates provided by the Ontario Ministry of Government Services, Actuarial Services Branch.

[1]Necessary population projections, participation rates and pensionable earnings taken from *Canada Pension Plan Actuarial Report No. 6 as at December 31, 1977* (Ottawa: Department of Insurance, mimeo, 1978).

Divorce data indicate that it is no longer exceptional for men and women to live through two complete family formations before they reach retirement age. This change in family dynamics, combined with the fact that women on average have less formal pension coverage, have lower earnings and exhibit higher labour mobility, makes it imperative that pension assets and pension income be divisible upon the dissolution of marriage or common law relationships. This should result in a significant improvement in the retirement income available to women.

Reduced Contributory Period for Maximum CPP Benefits

By increasing the general CPP drop-out provision from 15 to 25 per cent, the contributory period needed to receive a maximum CPP retirement benefit is reduced to 35 from 40 years. Because the additional years dropped from the benefit calculation could be periods in which the contributor had zero or below average earnings, this proposal will raise the average level of CPP benefits. The overall level of CPP benefits is expected to increase by about six per cent.

Table A5 differentiates by sex the estimated impact on average benefits earned of increasing the general drop-out to 25 per cent. Based upon projected participation rates and earnings ratios for persons aged 20 in 1980, it is expected that male CPP contributors will earn a three per cent average increase in benefits. In contrast, female CPP contributors are expected to earn an additional 10 per cent in benefits on average. Credit-splitting between spouses will affect the actual benefits received.

This threefold difference in impact occurs because women, on average, participate in the labour force less than men, and when they do, they earn less. The 25 per cent general drop-out provision allows more years of zero or low earnings to be excluded from the CPP's earnings-related benefit formula, and thus results in the payment of higher pensions. As with the proposed employment pension plan reforms, the magnitude of this sex-based differential impact will decline as male and female earnings and employment patterns grow more similar.

Table A6 presents five case examples of the impact of the increased general drop-out on a single contributor's monthly CPP retirement pension. The illustrations vary by the total number of years worked and by whether earnings were at or below the YMPE. Benefit entitlements are expressed in monthly dollar amounts with the maximum available monthly benefit equal to the 1984 level of $387.50.[2]

[2]Numerical examples relating to the CPP in this appendix assume that the CPP has been in operation for 47 years so that benefit levels are calculated on the basis of a mature CPP.

Impact on Single Contributor of Reduced Contributory Period Monthly Benefit, 1984[1]			Table A6
	Retirement Pension		
Employment History	Under Current 15% Drop-Out	Under Proposed 25% Drop-Out	Percentage Increase
	($)	($)	(%)
Earnings at YMPE:			
1. Contributor begins work at age 18, is unemployed for 8 years, works to age 65 (i.e., works 39 years).	377.81	387.50	2.6
2. Contributor begins work at age 22, drops out for 9 years, works to age 65 (i.e., works 34 years).	329.38	376.43	14.3
3. Contributor begins work at age 28, drops out for 10 years, works to age 65 (i.e., works 27 years).	261.56	298.93	14.3
Earnings below YMPE:			
4. Contributor begins work at age 18, works to age 65, earns at ½ YMPE for 10 years and at YMPE for 37 years (i.e., works 47 years).	372.97	387.50	3.9
5. Same as example 3, but earns at ½ YMPE for 5 years and at YMPE for 22 (i.e., works 27 years).	237.34	271.25	14.3

[1]Although the CPP started on 1966, this table assumes that it has been in operation for 47 years. The table provides simplified examples of CPP contributory situations for illustrative purposes only.
Assumptions:
- The contributor has no spouse.
- The contributor first contributed to the CPP at 18 years of age; consequently the contributory periods are 47 years less the present drop-out of 15 per cent (equal to 7 years), or the proposed 25 per cent (equal to 12 years).
- The maximum CPP monthly benefit is $387.50 for 1984.

Contributors who work fewer than 40 years in total but have always contributed at the YMPE will receive an improved benefit under the proposed lower minimum contributory period. Case 1 illustrates that a person working 39 years would be 2.6 per cent better off with a 25 per cent drop-out. Case 2 indicates that a person working 34 years would have his or her pension improved by 14.3 per cent.

The 25 per cent general drop-out also benefits those contributors who have been employed steadily, but with some years of markedly lower earnings. These periods of low earnings could reflect years in which workers were laid off temporarily or held only part-time jobs in order to spend time acquiring new skills. Case 4 illustrates that individuals working the full 47 years between ages 18 and 65, but with 10 years at uncharacteristically low earnings, would realize a 3.9 per cent increase in retirement income because of the move from a 15 to a 25 per cent general drop-out.

Credit-Splitting at Retirement

The proposal to introduce credit-splitting at retirement gives each spouse one-half of the other spouse's CPP credits accrued during the relationship. This explicitly recognizes

Impact of Credit-Splitting at Retirement — Table A7
Monthly Benefit, 1984[1]

		Before Credit-Splitting	After Credit-Splitting
		($)	($)
One Earner			
Earner at YMPE		387.50	193.75
Spouse does not work		0	193.75
(earner starts work after marriage at age 25)	Total	387.50	387.50
Two Earners			
One at YMPE		387.50	290.63
One at ½ YMPE		193.76	290.63
(Both start work after marriage at age 25)	Total	581.26	581.26
Two Earners			
One at YMPE		387.50	249.11
One at ½ YMPE		55.36	193.75
(Both start work at age 25, married at 35, lower-paid stops work at marriage)	Total	442.86	442.86

[1]Spouses are assumed to be the same age. Assumes 25 per cent general drop-out has been implemented.

the contribution that both spouses make to the accumulation of the CPP credits.

Table A7 illustrates the impact of credit-splitting in three sample cases. In case 1, one spouse earns at the YMPE and credit-splitting gives the non-earning partner half of the earner's pension. While the total CPP income flowing into the household remains unchanged, the non-earner receives a CPP pension in his or her own right. With no credit-splitting, all CPP income would flow to the earner. The net effect, as Table A7 shows, is to increase the non-earning spouse's CPP pension from zero to $193.75.

In case 2, where both partners commence work upon marriage, credit-splitting increases the lower-paid partner's CPP pension from $193.76 to $290.63 and reduces the higher-paid partner's pension to $290.63, for a total combined CPP income of $581.26.

In case 3, both spouses work before marriage and accumulate some CPP credits that are not subject to credit-splitting upon retirement. In this case, the lower-paid partner's pension upon retirement increases from $55.36 before credit-splitting to $193.75, and the higher-paid partner's pension reduces to $249.11.

Although CPP credit-splitting can be of benefit to both spouses, depending upon their respective earnings histories, women are more likely to be the beneficiaries of this reform. As women's earnings levels and earnings histories approach those of their male counterparts, the impact of credit-splitting in ongoing marriages will be more evenly divided between male and female partners in a marriage.

CPP Child-Rearing Drop-Out Provision

In response to the recommendations of both the Royal Commission on the Status of Pensions in Ontario and the Select Committee on Pensions, as well as the many representations made by interested groups across Canada, the Government of Ontario set aside its long-standing reservations about the CPP Child-Rearing Drop-Out amendment. The amendment was ratified by Ontario in June, 1983, and is now part of the Canada Pension Plan.

This additional drop-out provision allows parents who leave employment in order to raise children under the age of seven to exclude or "drop" those years from the calculation of their CPP benefits. This has the effect of raising their CPP benefits. Although the provision is available to both sexes, women will be the most affected.

In a study prepared for the Economic Council of Canada, it was estimated that the average woman with children will receive about a 22 per cent increase in benefits because of this feature. The cost of the provision will result in an estimated 0.3 percentage point increase in the CPP's long-run pay-as-you-go contribution rate.[3]

Credit-Splitting and the Child-Rearing Drop-Out Amendment

The application of credit-splitting at retirement will generally leave the total CPP income of the household unchanged. However, when combined with the special child-rearing drop-out, credit-splitting may result in a decline in the level of CPP benefits flowing into the household. Table A8 illustrates a situation where credit-splitting and the child-rearing drop-out increases the pension received by the lower-earning spouse but, at the same time, reduces the total monthly CPP income from $678.13 to $657.36.

To ensure that total CPP income does not decrease as a result of credit-splitting, the retirement pensions of each spouse will be increased in proportion to the benefits received by the spouses after credit-splitting. Thus, in the example in Table A8, the higher-paid spouse would get an additional $10.06 and the lower-paid spouse an additional $10.71, to bring the total household CPP income to $678.13, the level available to the household before credit-splitting. Also, if credit-splitting results in one spouse receiving a pension that exceeds the maximum retirement pension payable under the CPP, that spouse's pension will be held at the maximum level and the difference will be added to the benefit of the other spouse.

Combined Impact of Credit-Splitting and the Child-Rearing Drop-Out Amendment Monthly Benefit, 1984 — Table A8

	Before Credit-Splitting[1]	After Credit-Splitting[1]	Change	% Change	After Credit-Splitting (With Adjustment)	% Change (With Adjustment)
Two Earners						
One at YMPE	387.50	318.30	–69.20	–17.9	328.36	–15.3
One at ¾ YMPE, drops out 10 years of zero earnings for child-rearing (Both start work after marriage at age 25)	290.63	339.06	+48.43	+16.7	349.77	+20.3
	678.13	**657.36**	**–20.77**		**678.13**	

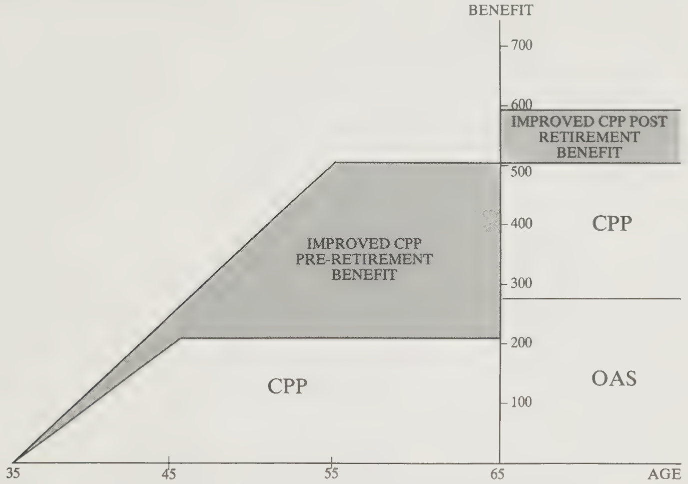
[1]Assumes 25 per cent general drop-out has been implemented.

Improved CPP Benefits for Survivors Without Dependants

Ontario's proposals to improve existing pre- and post-retirement CPP benefits for survivors without dependants will increase their pension benefits in or near retirement. Figure A1 portrays graphically the relationship between current CPP survivor benefits and On-

[3]S.A. Rea, Jr., *Redistributive Effects of Canada's Public Pension Programs,* Economic Council of Canada (Ottawa: Department of Supply and Services, 1981).

Comparison of Current and Proposed CPP Survivor Benefits, 1984 — Figure A1



tario's proposed changes by the age of the survivor. The shaded area indicates the proposed benefit increases.

The increased pre-retirement benefits for survivors without dependants retain the basic structure of the existing plan, which is recognized as being fundamentally sound. However, the flat-rate component is raised to the OAS level, the earnings component is increased to

Impact of Proposed Pre-Retirement Survivor Benefits, No Dependants
Monthly Benefits, 1984 — Table A9

	Deceased Spouse with Earnings at Proportion of YMPE		
	50%	**75%**	**100%**
Survivor, 45			
Current:			
$ per month	156.53	192.85	229.18
Proposed:			
$ per month	193.13	222.19	251.25
$ increase	36.60	29.34	22.07
% increase	23.4	15.2	9.6
Survivor, 55			
Current:			
$ per month	156.53	192.85	229.18
Proposed:			
$ per month	386.25	444.38	502.50
$ increase	229.72	251.53	273.32
% increase	146.8	130.4	119.3

60 per cent, and the benefit reduction factor is applied below age 55. Under this structure, the maximum monthly benefit payable to a survivor aged 55 to 64 will be $502.50 instead of $229.18. As the shaded area of the diagram illustrates, even with the earlier application of the reduction factor, all pre-retirement survivors will receive higher benefits.

Examples of the impact of Ontario's proposal on survivors aged 45 and older without dependants are presented in Table A9. Maximum monthly CPP benefits for a survivor aged 45 whose spouse earned one-half of the YMPE would increase from $156.53 to $193.13, an increase of 23.4 per cent. For a survivor aged 45 whose spouse earned at the YMPE, the benefit rises from $229.18 to $251.25, an increase of 9.6 per cent. This reduction in the percentage increase is due to the change in the flat-rate component to $270 from the current level of $83.87. This redistributes income to the survivors of spouses with low earnings.

A survivor aged 55 to 64 would realize the largest benefit increases. The magnitude of these increases would decline the higher the previous earnings of the deceased spouse. If the deceased spouse earned at one-half the YMPE, the proposal would raise the survivor's pension by $229.72, or 146.8 per cent. For a survivor whose spouse earned at the YMPE, the monthly benefit would rise by $273.32, or an increase of 119.3 per cent. Again, the reduction in the percentage increase is due to the increase in the flat-rate component of the benefit to the OAS level.

For a survivor over age 65, the proposed basic post-retirement survivor benefit is 80 per cent of the total CPP income flowing into the household. Thus, for a survivor who did not contribute directly to the CPP, the maximum available survivor pension would increase from the current $232.50 level to $310. In the case where the surviving spouse has contributed directly to the CPP, total retirement or survivor pensions from the CPP could exceed the $310 level. However, as under the current plan, maximum post-retirement benefits would still be capped at the maximum benefit level available to a single CPP contributor, which is $387.50 in 1984.

Post-Retirement Survivor Benefits
Monthly Benefits, 1984

Table A10

Survivor with Pension at Proportion of Maximum	Deceased Spouse with Pension or Earnings at Proportion of Maximum									
	0%	Replacement Rate	25%	Replacement Rate	50%	Replacement Rate	75%	Replacement Rate	100%	Replacement Rate
(%)	($)	(%)	($)	(%)	($)	(%)	($)	(%)	($)	(%)
0%										
Current	0	0	58.13	60	116.25	60	174.38	60	232.50	60
Proposed	0	0	77.50	80	155.00	80	232.50	80	310.00	80
25%										
Current	96.88	100	133.20	69	174.38	60	232.50	60	290.63	60
Proposed	77.50	80	155.00	80	232.50	80	310.00	80	387.50	80
50%										
Current	193.75	100	230.08	80	266.41	69	302.74	63	348.75	60
Proposed	155.00	80	232.50	80	310.00	80	387.50	80	387.50	67
75%										
Current	290.63	100	326.95	84	363.28	75	387.50	67	387.50	57
Proposed	232.50	80	310.00	80	387.50	80	387.50	67	387.50	57
100%										
Current	387.50	100	387.50	80	387.50	67	387.50	57	387.50	50
Proposed	310.00	80	387.50	80	387.50	67	387.50	57	387.50	50

Table A10 illustrates the impact of the improved post-retirement survivor benefits. Under the current benefit structure, maximum benefits for survivors with no CPP in their own right is $232.50 per month, for a replacement rate of 60 per cent of CPP funds flowing into the household prior to the death of the spouse. Ontario's proposals would raise this benefit to $310, for a replacement rate of 80 per cent.

Since CPP pensions are split between the spouses on retirement, Ontario's post-retirement survivor benefits proposal has the result of reducing the benefit to a survivor with CPP pensionable earnings who is predeceased by a spouse with no CPP pensionable earnings. An example of this situation is shown in the first column of Table A10. Under the current system, the survivor would continue to receive a CPP retirement pension for an effective 100 per cent survivor benefit. Under the proposal for credit-splitting, however, the survivor, before the death of the spouse, would have received only a portion of the CPP pension earned directly by his or her own contributions. The proposed CPP survivor benefit after credit-splitting would drop to 80 per cent of the CPP income flowing into the household before the death of the spouse. Whereas this situation can be considered to be anomalous, it results from the application of the credit-splitting provision. Since credit-splitting divides CPP pensions between spouses, total CPP income of the household is reduced to 80 per cent, regardless of which spouse dies and results in equal treatment of both spouses under the survivor benefit proposal.

Table A10 also reveals that replacement rates decline as the survivor's pension in his or her own right increases and as the deceased spouse's pension or earnings are higher. The minimum replacement rate is 50 per cent, which occurs when both spouses had earnings at the YMPE. This declining pattern indicates that the proposed post-retirement survivor benefits will increase pensions for those survivors with a history of low earnings, and maintain the existing benefit levels for those with the highest earnings.

Because women generally outlive their spouses at all ages, they will be the principal beneficiaries of the proposed increases in pre- and post-retirement survivor benefits. This is confirmed by Table A11, which presents the distribution of new surviving spouses' pensions by age and sex for a typical month. Of all new survivors' pensions, 3,288 (89 per cent) went to females. In addition, 89 per cent of the 2,771 survivors aged 55 years or older were women. This is the target group of Ontario's proposals for improved pre- and post-retirement survivor benefits.

Distribution of New Surviving Spouses' Pensions by Age and Sex — Table A11
June, 1983

Age	Male	Female	Total
Under 35	12	109	121
35-44	34	224	258
45-54	82	483	565
55-64	113	953	1,066
65+	186	1,519	1,705
Total	427	3,288	3,715

Source: Canada Pension Plan Statistical Bulletin, Volume 15, Number 2 (Ottawa: National Health and Welfare, June, 1983).

The proposals are also intended to be retroactive, except in cases where this would result in a reduction of current benefits being paid. In June, 1983,surviving CPP spouses' pensions were being paid to 321,000 individuals, of whom 92.6 per cent were females. Nearly all of these women would benefit from the recalculation and upgrading of survivors' pensions.

Improved CPP Benefits For Survivors with Dependants

Ontario proposes survivor benefits for survivors below age 35 who are caring for dependants. This is in recognition of the fact that there are fixed costs associated with the rearing of children, and the drop in income as a result of the death of the spouse will increase the burden on the survivor.

The earnings component of the benefit is proposed to remain at 37.5 per cent of the spouse's imputed CPP pension. Again, this recognizes the earnings-related nature of the CPP. The flat-rate benefit would consist of two parts: a benefit of $83.87 for each dependant and $186.13 in respect of the survivor. This, in effect, makes the flat-rate benefit for a survivor with one dependant equal to the OAS level, with each subsequent dependant receiving an additional $83.87.

As under current CPP rules, a child would be considered a dependant until he or she reaches 18 years of age, or 25 years of age if a full-time student.

A survivor under age 35 would, therefore, receive a full CPP survivor benefit, as long as he or she still has dependants. The portion of the benefit payable in respect of these dependants will cease once the dependancy status ceases.

Table A12 illustrates the amount of survivor benefit payable to a survivor below age 35 with one and with two dependants. As shown in the table, the proposed benefit would increase payments in 1984 to survivors with one dependant from $240.40 to $342.66, for a percentage increase of 42.5 per cent. This percentage increase declines as the income of the deceased spouse is higher, effectively redistributing the benefit in favour of lower income survivors. A survivor with one dependant whose spouse earned at the YMPE would receive a 32.7 per cent increase in benefits as compared to the current situation. Similarly, in the case of survivor with two dependants, the percentage increase is higher for lower income survivors.

Current and Proposed Pre-Retirement Survivor Benefits, With Dependants
Monthly Benefits, 1984

Table A12

	Deceased Spouse with Earnings at Proportion of YMPE		
	50%	**75%**	**100%**
Survivor, 30, 1 dependant			
Current:			
$ per month	240.40	276.72	313.05
Proposed:			
$ per month	342.66	378.98	415.31
$ increase	102.26	102.26	102.26
% increase	42.5	37.0	32.7
Survivor, 30, 2 dependants			
Current:			
$ per month	324.27	360.59	396.92
Proposed:			
$ per month	426.52	462.85	499.18
$ increase	102.26	102.26	102.26
% increase	31.5	28.4	25.8

Appendix B

CPP Cash-Flow and Fund-Size Projections

Tables B1, B2 and B3 present the financial characteristics of the provincial financing consensus under three different fertility rate assumptions. The projections have been provided by the Canada Pension Plan Division of the federal Department of Insurance.

Gross Cash Flow

Gross Cash Flow (GCF) is the annual amount of surplus funds available for borrowing, excluding the value of maturing debentures. When GCF figures are negative, the CPP investment fund is being reduced to help finance benefits. Under the 2.1 fertility rate assumption, GCF remains positive during the projection but declines overall relative to Gross National Product (GNP) during the later years of the projection. GCF will turn negative under 1.8 fertility assumptions after 2030, and after 2025 under 1.4 fertility assumptions.

Net Cash Flow

Net Cash Flow (NCF) equals the CPP's gross cash flow less interest payments to the investment fund. When NCF is positive, provincial interest payments to the fund are less than the money available for borrowing. When NCF is negative, interest payments to the fund exceed the money available for borrowing. A negative NCF also indicates that provincial interest payments are being used to help finance CPP benefits. Under the three fertility assumptions, NCF remains negative until after 1995, at which time contribution inflows again exceed benefit outflows. NCF again turns negative after 2020 under 2.1 and 1.8 fertility. Using 1.4 fertility assumptions, NCF turns negative after 2015.

Fund/Benefit Ratio

This ratio measures the size of the CPP fund relative to the expected annual benefit payout three years in advance. When the ratio reduces to 2.0, the contribution rate would be raised to the pay-as-you-go level and the investment fund would become a contingency fund used to compensate for short-run imbalances in contribution inflows and benefit outflows. Under the 2.1 fertility assumption, the ratio does not drop to the 2.0 level during the projection period. With the 1.8 assumption, the 2.0 level is reached after 2035. Under 1.4 fertility, the ratio reaches 2.0 after 2030.

Impact of Funding on CPP Contribution Rate

Increased funding would enable the nine per cent CPP contribution rate to be maintained even though the underlying pay-as-you-go rate may be higher. By how much and how long the contribution rate can be held at nine per cent depends upon future fertility rates.

Under the 2.1 fertility assumption, increased funding allows the contribution rate to be held below the higher pay-as-you-go-rate from about 2025 to beyond 2100. However, the differential between the nine per cent level and the pay-as-you-go contribution rate does not exceed 1.5 percentage points.

With a 1.8 fertility rate assumption, the magnitude of the differential between nine per cent and the pay-as-you-go rate rises to 2.6 percentage points, but the period over which the differential can be maintained will be from 2020 to about 2037.

Finally, under the 1.4 fertility assumption, the period over which the contribution rate can be held at the nine per cent level is further compressed. The contribution rate would be raised to the pay-as-you-go level of about 13 per cent when the benefit fund ratio declines to 2.0 after 2030.

Canada Pension Plan Cash Flow Projection under Provincial Financing Consensus using 2.1 Total Fertility Assumption: Selected Years, 1982-2050

Table B1

	Contribution Rates		Gross Cash Flow[1]		Net Cash Flow		Fund Size		Ratio[2]
Year	Consensus (%)	Paygo (%)	($ million)	% of GNP	($ million)	% of GNP	($ million)	% of GNP	(%)
1982	3.60	3.60	2,272	0.64	254	0.07	23,100	6.48	4.57
1983	3.60	3.60	2,398	0.60	75	0.02	25,500	6.39	4.42
1984	3.60	3.65	2,483	0.55	–65	–0.01	28,000	6.21	4.29
1985	3.60	3.84	2,415	0.49	–317	–0.06	30,400	6.15	4.15
1986	3.60	4.04	2,260	0.42	–625	–0.12	32,600	6.07	4.00
1987	3.80	4.31	2,265	0.40	–770	–0.14	34,900	6.14	3.87
1988	4.00	4.52	2,350	0.39	–836	–0.14	37,300	6.13	3.77
1989	4.20	4.73	2,420	0.37	–915	–0.14	39,700	6.14	3.66
1990	4.40	4.89	2,579	0.37	–904	–0.13	42,300	6.11	3.58
1995	5.40	5.59	3,943	0.42	–463	–0.05	58,700	6.27	3.34
2000	6.40	6.05	6,956	0.55	1,167	0.09	86,600	6.84	3.44
2005	7.40	6.36	12,904	0.75	4,731	0.28	137,500	8.03	3.81
2010	8.40	6.87	23,012	1.00	9,341	0.41	231,000	10.04	4.31
2015	9.00	7.77	32,679	1.07	10,003	0.33	379,000	12.55	4.75
2020	9.00	8.81	35,719	0.90	2,032	0.05	553,500	14.08	4.74
2025	9.00	9.82	33,625	0.65	–11,315	–0.22	727,800	14.16	4.38
2030	9.00	10.54	27,051	0.40	–27,666	–0.41	875,800	13.07	3.91
2035	9.00	10.50	27,624	0.31	–35,638	–0.40	1,009,800	11.38	3.47
2040	9.00	10.21	34,790	0.29	–38,162	–0.32	1,166,700	9.83	3.11
2045	9.00	9.93	46,987	0.30	–38,871	–0.25	1,377,600	8.76	2.81
2050	9.00	9.94	49,658	0.24	–52,001	–0.25	1,626,700	7.86	2.49

Notes: [1]Cash flows exclude the value of maturing debentures.
[2]Ratio expresses the ratio of the fund in year t to the level of benefits in year t + 3.

Economic Assumptions:	1982	1983	1984	1985	1986	1987	1988 +	Demographic Assumptions:	1990 +
Earnings Growth	10.40	6.00	5.50	5.00	5.00	5.00	5.00	Total Fertility Rate	2.1
Inflation	10.50	7.50	6.50	5.50	4.50	4.00	3.50	Net Immigration	
Interest	15.07	10.00	8.00	6.50	6.50	6.50	6.50	(% of Population)	0.33

Canada Pension Plan Cash Flow Projection under Provincial Financing Consensus using 1.8 Total Fertility Assumption: Selected Years, 1982-2050

Table B2

	Contribution Rates		Gross Cash Flow[1]		Net Cash Flow		Fund Size		Ratio[2]
Year	Consensus (%)	Paygo (%)	($ million)	% of GNP	($ million)	% of GNP	($ million)	% of GNP	(%)
1982	3.60	3.60	2,272	0.64	254	0.07	23,100	6.48	4.57
1983	3.60	3.60	2,398	0.60	75	0.02	25,500	6.39	4.42
1984	3.60	3.65	2,483	0.55	-65	-0.01	28,000	6.21	4.29
1985	3.60	3.84	2,416	0.49	-316	-0.06	30,400	6.15	4.16
1986	3.60	4.04	2,262	0.42	-624	-0.12	32,600	6.07	4.00
1987	3.80	4.31	2,267	0.40	-768	-0.14	34,900	6.14	3.87
1988	4.00	4.51	2,352	0.39	-834	-0.14	37,300	6.13	3.77
1989	4.20	4.73	2,424	0.37	-911	-0.14	39,700	6.14	3.67
1990	4.40	4.89	2,585	0.37	-899	-0.13	42,300	6.11	3.58
1995	5.40	5.58	3,965	0.42	-446	-0.05	58,800	6.28	3.35
2000	6.40	6.04	7,002	0.55	1,197	0.09	86,900	6.87	3.46
2005	7.40	6.38	12,808	0.75	4,617	0.27	137,700	8.09	3.82
2010	8.40	6.97	22,154	0.98	8,581	0.38	228,800	10.12	4.28
2015	9.00	8.00	29,932	1.02	7,872	0.27	367,300	12.57	4.62
2020	9.00	9.22	29,574	0.78	-2,179	-0.06	518,600	13.73	4.45
2025	9.00	10.46	21,507	0.45	-18,758	-0.39	645,700	13.47	3.89
2030	9.00	11.44	4,601	0.07	-40,223	-0.65	704,300	11.41	3.15
2035	9.00	11.64	-12,386	-0.15	-56,279	-0.70	677,000	8.44	2.34
2040	9.00	11.56	-33,918	-0.33	-70,923	-0.68	553,100	5.31	1.49
2045	9.00	11.46	-66,667	-0.49	-88,572	-0.66	292,500	2.17	0.61
2050	9.00	11.58	-126,692	-0.73	-119,476	-0.69	-207,800	-1.20	N/A

Notes: [1]Cash flows exclude the value of maturing debentures.
[2]Ratio expresses the ratio of the fund in year t to the level of benefits in year t + 3.

Economic Assumptions:	1982	1983	1984	1985	1986	1987	1988+	Demographic Assumptions:	1990+
Earnings Growth	10.40	6.00	5.50	5.00	5.00	5.00	5.00	Total Fertility Rate	1.8
Inflation	10.50	7.50	6.50	5.50	4.50	4.00	3.50	Net Immigration	
Interest	15.07	10.00	8.00	6.50	6.50	6.50	6.50	(% of Population)	0.33

Canada Pension Plan Cash Flow Projection under Provincial Financing Consensus using 1.4 Total Fertility Assumption: Selected Years, 1982-2050

Table B3

	Contribution Rates		Gross Cash Flow[1]		Net Cash Flow		Fund Size		Ratio[2]
Year	Consensus (%)	Paygo (%)	($ million)	% of GNP	($ million)	% of GNP	($ million)	% of GNP	(%)
1982	3.60	3.60	2,272	0.64	254	0.07	23,100	6.48	4.57
1983	3.60	3.60	2,399	0.60	75	0.02	25,500	6.39	4.42
1984	3.60	3.65	2,484	0.55	–64	–0.01	28,000	6.21	4.29
1985	3.60	3.84	2,417	0.49	–315	–0.06	30,400	6.15	4.16
1986	3.60	4.04	2,264	0.42	–622	–0.12	32,600	6.07	4.00
1987	3.80	4.31	2,269	0.40	–766	–0.13	34,900	6.14	3.87
1988	4.00	4.51	2,357	0.39	–830	–0.14	37,300	6.13	3.77
1989	4.20	4.73	2,430	0.38	–906	–0.14	39,700	6.14	3.67
1990	4.40	4.88	2,592	0.37	–893	–0.13	42,300	6.11	3.59
1995	5.40	5.57	3,992	0.43	–425	–0.05	58,900	6.29	3.36
2000	6.40	6.03	7,063	0.56	1,238	0.10	87,200	6.90	3.49
2005	7.40	6.41	12,680	0.75	4,465	0.26	137,900	8.16	3.84
2010	8.40	7.11	21,008	0.95	7,567	0.34	225,900	10.24	4.24
2015	9.00	8.33	26,262	0.93	5,025	0.18	351,700	12.58	4.43
2020	9.00	9.83	21,367	0.60	–7,802	–0.22	472,100	13.44	4.07
2025	9.00	11.45	5,392	0.12	–28,636	–0.65	536,100	12.25	3.25
2030	9.00	12.89	–24,960	–0.46	–56,639	–1.00	476,600	8.72	2.14
2035	9.00	13.53	–64,311	–0.94	–82,668	–1.20	238,800	3.48	0.82
2040	9.00	13.88	–121,677	–1.40	–111,800	–1.30	–245,700	–2.91	N/A
2045	9.00	14.20	–209,584	–1.90	–149,109	–1.40	–1,102,700	–10.04	N/A
2050	9.00	14.54	–344,471	–2.60	–198,859	–1.50	–2,534,900	–19.06	N/A

Notes: [1]Cash flows exclude the value of maturing debentures.
[2]Ratio expresses the ratio of the fund in year t to the level of benefits in year t + 3.

Economic Assumptions:	1982	1983	1984	1985	1986	1987	1988+
Earnings Growth	10.40	6.00	5.50	5.00	5.00	5.00	5.00
Inflation	10.50	7.50	6.50	5.50	4.50	4.00	3.50
Interest	15.07	10.00	8.00	6.50	6.50	6.50	6.50

Demographic Assumptions:	1990+
Total Fertility Rate	1.4
Net Immigration (% of Population)	0.33

Appendix C

The Impact of Inflation and Inflation Protection Formulae on Pension Costs

An often misunderstood aspect of pension reform is the relationship between inflation protection and pension costs. The usual argument against mandatory escalation of pension benefits is its high cost.

Reducing inflation to zero does not avoid increases in pension costs. The opposite is true. The achievement of zero inflation would have a greater impact on employment pension plans that if mandatory 60 per cent inflation protection were implemented in the current economic environment.

The real issue underlying mandatory inflation protection is the existence and allocation of the inflation component of pension plan investment earnings. By mandating inflation protection, pension reform recognizes that a share of the inflation component belongs to plan members and should be used, regularly and predictably, to escalate their benefits. The cost of inflation protection is not extraordinary; the cost only measures the impact of redirecting a proportion of the inflation component away from lowering pension costs and towards benefit escalation.

Long-Run Cost Increases

The relationship between pension reform costs, inflation and various inflation protection formulae in an example contributory five-year final average earnings pension plan is portrayed in Figure C1. The plan's annual accrual rate is 1.30 per cent of earnings up to the YMPE, and 1.85 per cent above the YMPE. The six lines in the graph relate pension plan costs under six reform scenarios to long-run inflation rates ranging from zero to 12 per cent.[1]

Scenario 1 portrays pension costs assuming no pension reforms are implemented. Scenarios 2 through 6 portray pension costs when basic pension reforms are implemented in conjunction with alternative inflation protection formulae. The alternative formulae range from zero to 100 per cent inflation protection. The vertical distances between lines 1 to 6 in Figure C1 measure the incremental cost of different reform scenarios at any given inflation rate.

For example, under the base assumption of six per cent inflation, the cost of pension reform, including 60 per cent inflation protection, is indicated by the distance between points A and B. Pension reform raises the long-run cost of the example plan from 6.1 to 8.6 per cent of payroll, for an increase of 2.5 percentage points. This assumes the example plan did not provide ad hoc inflation protection. Points A and B correspond to the pre- and post-reform cost estimates for contributory final average earnings pension plans contained in

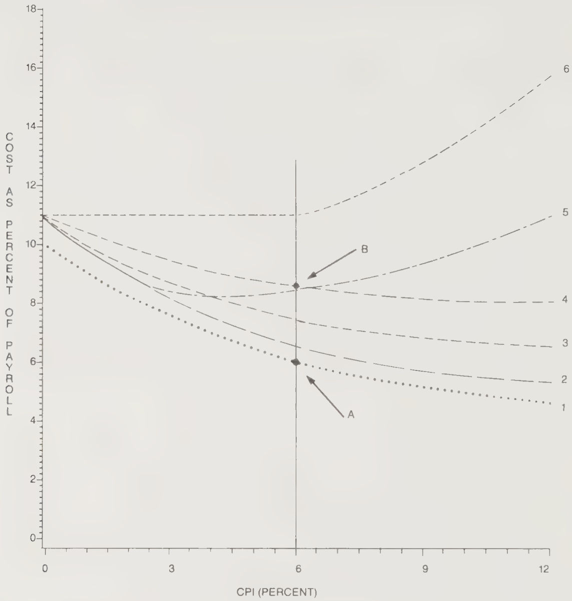
[1]The following table gives the economic assumptions used to calculate the point estimates of cost at selected inflation rates. Costs between the five point estimates were derived by interpolation.

Economic Assumptions

	Very Low	Low	Medium (Base)	High	Very High
	(%)	(%)	(%)	(%)	(%)
Inflation	0.00	3.00	6.00	9.00	12.00
Fund Rate	3.00	5.75	8.50	10.50	12.50
Salary Growth	1.50	4.50	7.50	10.00	12.50

Sensitivity of Cost to Inflation and Alternative Inflation Protection Formulae

Figure C1



[1]No reform; no inflation protection.
[2]Reform; no inflation protection.
[3]Reform; ad hoc 40 per cent inflation protection applied only to retireds.
[4]Reform; mandatory 60 per cent inflation protection applied to both retireds and deferreds.
[5]Reform; mandatory inflation protection CPI less 2.5 per cent applied to both retireds and deferreds.
[6]Reform; mandatory 100 per cent inflation protection applied to both retireds and deferreds.

Table 10 in Chapter VII.

The downward slope of line 1 reveals that, without inflation protection, pension plan costs decline as inflation increases. This occurs because rising prices erode the value of pensions promised and the inflation component of the plan's investment earnings can be used to lower costs instead of escalating benefits. The higher the rate of inflation, the larger the inflation component in investment earnings and the more plan costs can be reduced. A plan that costs 10 per cent of payroll when inflation is zero will cost only 6.1 per cent when inflation is six per cent.

Conversely, scenario 1 also indicates that, as inflation declines, pension costs increase. This occurs because there is less erosion of benefits promised and there is a smaller inflation component in the plan's investment earnings. To honour the pensions promised, additional contributions to the plan are required, which means higher costs. A plan that costs 6.1 per cent of payroll when inflation is six per cent will cost 10 per cent when inflation is zero. Reduced inflation means that, even in the absence of any reforms, plan sponsors inevitably face higher pension costs.

Scenarios 2, 3 and 4 portray pension costs after the implementation of pension reform

with three approaches to inflation protection. The vertical distance between lines 1 and 2 reveals the cost of pension reform without mandatory inflation protection. Lines 3 and 4 are progressively higher because they represent reform scenarios with increasing degrees of inflation protection. Line 3 assumes 40 per cent inflation protection applied only to retired members; this is an estimate of the level and extent of voluntary inflation protection provided by many private sector plans. Line 4 assumes 60 per cent inflation protection for both retired and deferred members, which is Ontario's proposal.

Under these three reform scenarios, the inverse relationship between inflation and pension costs remains unchanged. As inflation increases, costs decrease; conversely, as inflation decreases, costs increase. Even if pension reform does not include mandatory inflation protection, the reduction of inflation will inevitably lead to increased pension plan costs. For example, under scenario 2, pension costs will rise to 8.3 from 6.7 per cent of payroll, if long-run inflation is reduced to three per cent from six per cent.

Scenario 6 illustrates how inflation affects pension costs under a formula that escalates benefits by 100 per cent of changes in the CPI. The vertical distance between lines 2 and 6 under six per cent inflation reveals the high cost of including full inflation protection in a reform package.

The flatness of line 6 up to the six per cent inflation level reveals that a fully indexed pension plan in a moderately inflationary environment is no more expensive than an unindexed plan when inflation is zero. This is because the available inflation premium in the pension plan's investment earnings is enough to finance benefit escalation. However, as inflation rates increase, there is a growing possibility that investment returns will not generate a sufficient inflation premium to index pension benefits fully. Additional contributions would be required to keep benefits fully indexed. This phenomenon accounts for the upward curve of line 6 at inflation rates above six per cent.

Scenario 5 illustrates the inflation sensitivity of pension costs using a 2.5 per cent deductible escalation formula similar to that proposed by the Parliamentary Task Force on Pension Reform. Rather than protecting members by a fixed percentage of the CPI change, benefits are raised each year by increases in the CPI minus 2.5 per cent. When inflation is at or below 2.5 per cent, there is no benefit escalation. However, pension benefits are fully escalated by changes in the CPI above the deductible 2.5 per cent level.

Scenario 5 shows how pension costs first decline and then rise with inflation as a result of the deductible formula. At rates of inflation up to 2.5 per cent, there is no escalation of benefits and thus no inflation protection cost. The inflation component of investment earnings is fully used to lower plan costs. This explains why line 5 initially coincides with the costline representing pension reform with no inflation protection.

Above the 2.5 per cent level of inflation, the deductible formula means that eligible benefits must be escalated by an increasingly larger proportion of inflation. At the 6.25 per cent level, both the deductible method and Ontario's proposal result in the same level of inflation protection (60 per cent of CPI increases) and the same pension plan cost (8.6 per cent of payroll). At higher rates of inflation, the deductible formula protects against an increasing proportion of the inflation rate and is correspondingly more costly.

It is important to note that regardless of which inflation protection formula is specified, the total cost of the reform plan converges at the 11 per cent level when inflation is zero.

The analysis of the information contained in Figure C1 yields three significant policy insights:

- A zero inflation rate will not reduce pension costs; they would actually increase because there would be a smaller inflation component of investment earnings available to lower pension costs;

- Inflation protection under low and moderate changes in the CPI should not involve extraordinary costs because the inflation component of investment earnings can be used to finance benefit escalation; and
- The introduction of mandatory inflation protection would increase pension plan costs because plan sponsors would have to redirect some of the inflation component of their investment earnings away from lowering pension costs and towards the escalation of pension benefits.

The issue of inflation protection in pension plans revolves around the existence and allocation of the inflation component of a pension plan's investment earnings. Under existing pension legislation, there are no criteria for the allocation of the inflation component. Plan sponsors have used this to enrich the benefits of active plan members, to lower pension costs or to provide voluntary ad hoc inflation adjustments. In many cases, the inflation component has been withdrawn from plans as part of a declared pension plan surplus. By mandating inflation protection, pension reform recognizes that a proportion of the inflation component belongs to plan members and should be used, regularly and predictably, to escalate their benefits.

Long-Run Versus Unexpected Short-Run Cost Increases

The above analysis concentrated on long-run pension cost estimates. This means that level or unchanging assumptions about the long-run relationship between investment earnings, wage growth and inflation have been used to calculate the various cost levels illustrated in Figure C1. While this approach is useful in explaining the long-run cost implications for various reform packages, it fails to recognize that these relationships are not stable in the short run. Unexpected adverse changes in the relationships between these three crucial variables can have a significant impact on pension costs faced by plan sponsors.

For example, with mandatory inflation protection, an unexpected sharp increase in inflation could result in a correspondingly sharp rise in pension liabilities, which would impose additional pension costs upon a plan sponsor. These additional costs must be met at the same time the plan sponsor faces other equally important demands on the organization's revenues. It is cold comfort to a plan sponsor to know that pension escalation is affordable in the long run, when the organization must first survive in the short run.

Pension reform must ease the impact of absolute cost increases and shield plan sponsors from exposure to unexpected cost increases because of mandatory inflation protection. This can be accomplished in a number of ways.

First, mandatory inflation protection should be expressed as a proportion of CPI changes, not as a deductible. This builds in an automatic escape valve for inflation-induced increases in a pension plan's liabilities. At higher rates of inflation, if there is a sharp increase in the CPI, the proportional formula softens the impact on a pension plan's liabilities.

Second, a cap on mandatory escalation of benefits should be introduced. The proposed eight per cent maximum, while providing plan members with a good level of inflation protection, limits a plan sponsor's exposure to financial risks. Without a cap, employers sponsoring pension plans would be facing an open-ended cost commitment that would induce some employers to discontinue plans, discourage other employers from establishing new plans, and as a result, pension coverage would be reduced.

Third, funding arrangements should be made more flexible. Amortization periods for financing experience deficiencies could be lengthened from five to ten years. As well, amortization payments calculated as a level percentage of payroll could be used instead of level payments. Both these changes would lessen the short-run impact of unexpected experience deficiency payments.

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